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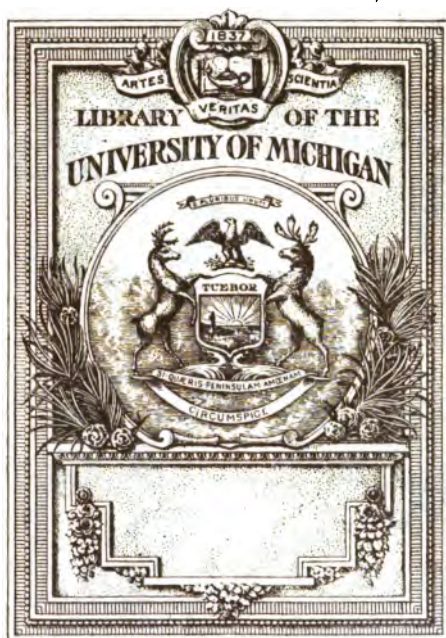
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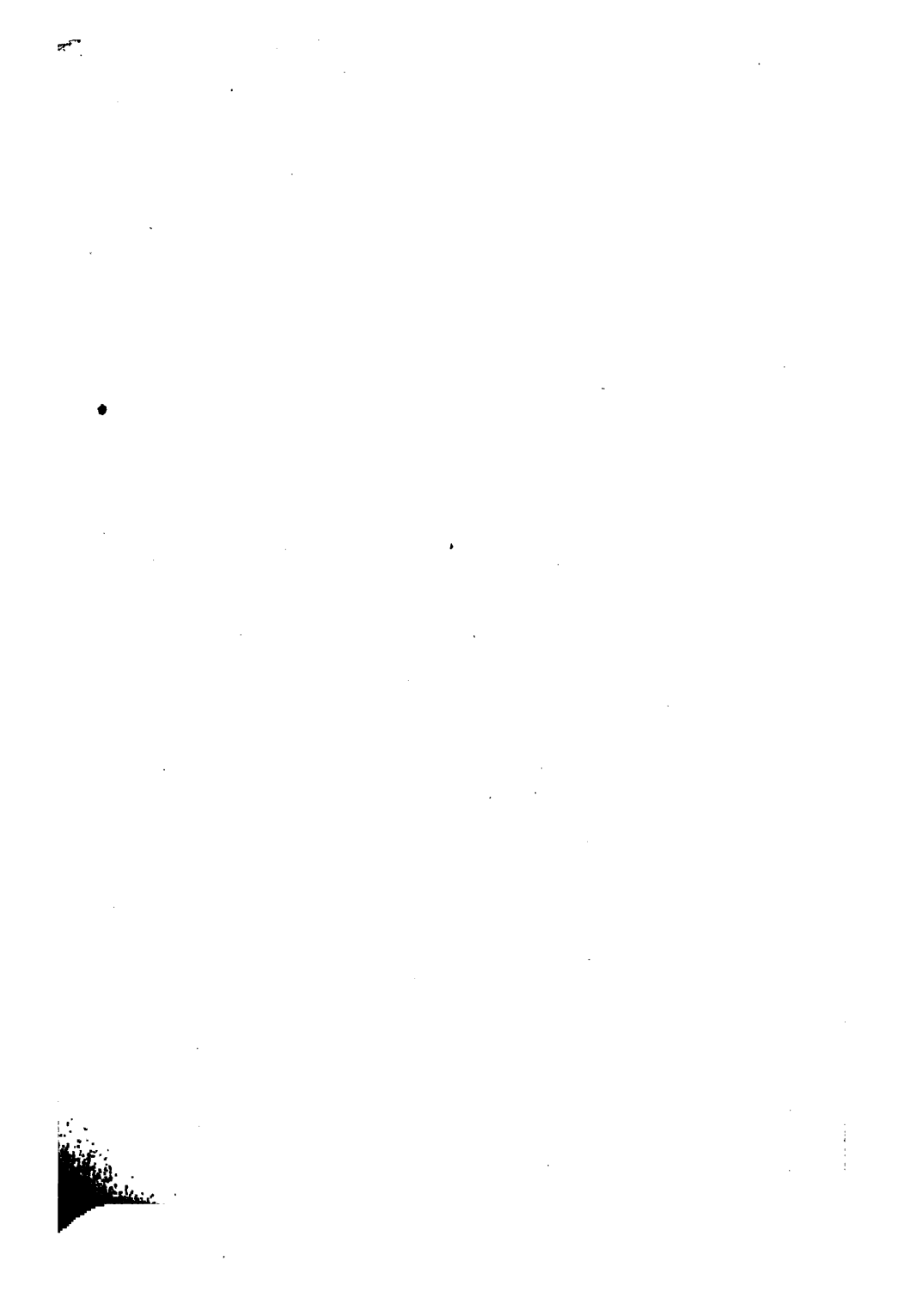
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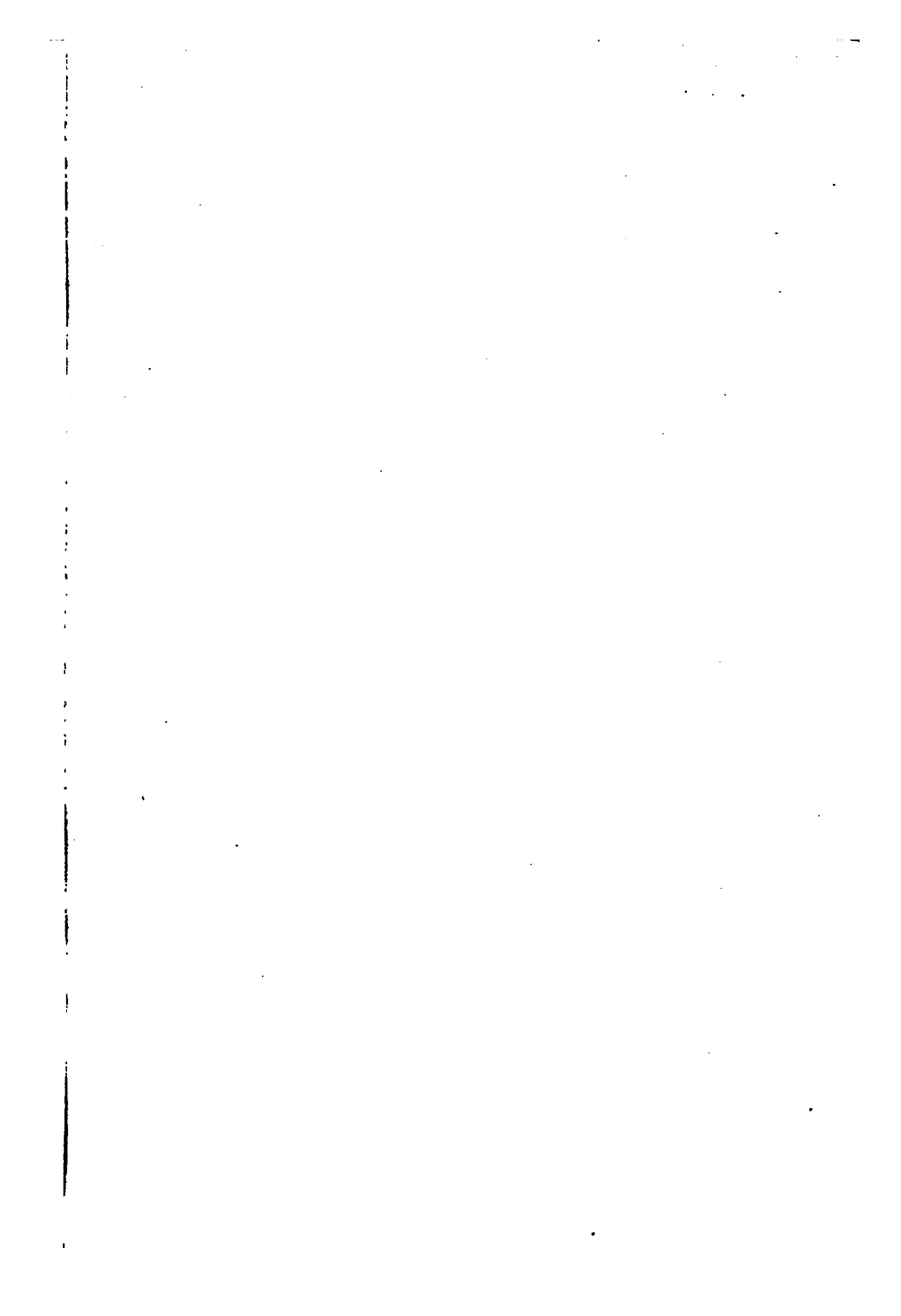


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# Modern Business

**A SERIES OF TEXTS PREPARED AS  
PART OF THE MODERN BUSINESS  
COURSE AND SERVICE OF THE  
ALEXANDER HAMILTON  
INSTITUTE**



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# Modern Business

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# CREDIT AND THE CREDIT MAN

BY

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**MODERN BUSINESS**

VOLUME 8

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## PREFACE

The growth and increasing complexity of business have forced upon the latter-day business world a salutary recognition of the value of scientific methods as applied to the management of business, tho of such methods the credit department appears to have received less than its due share.

Altho the present volume of the Modern Business Text aims to cover the whole field of commercial credit, including therein modern collection procedure in both wholesale and retail business, special emphasis is laid upon the discussion of credit title and upon the analysis of credit information with a view to determining the existence of such title on the credit seeker's part. In that connection many factors which at first glance may appear unimportant if not irrelevant are found to exercise a decided influence.

The reader who is more or less familiar with ordinary credit practice will find in this volume considerable new light shed upon old questions, and will be ready to admit, it is hoped, that the credit policy herein advocated commends itself as safe and profitable in the conduct of a modern credit department.

Not the least important part of this work is that which discusses the means by which the credit man

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is made a constructive force in business—a subject strictly in line with modern ideas of service as an integral part of successful business practice.

The author wishes to acknowledge his indebtedness to Professor Charles W. Gerstenberg, for the chapter on Bankruptcy Law and Practice and for that part of Chapter XIV which describes the legal remedies available for the protection of merchandise creditors.

P. P. WAHLSTAD.

New York,  
October, 1916.

## TABLE OF CONTENTS

### CHAPTER I

NATURE AND FUNCTIONS OF CREDIT		
SECTION		PAGE
1.	The Magic of Credit . . . . .	1
2.	Meaning of Credit . . . . .	3
3.	Relation of Credit to Capital . . . . .	4
4.	Credit and Civilization . . . . .	4
5.	Place of Confidence in Credit Transactions . . . . .	6
6.	Confidence Supported by Contract . . . . .	6
7.	Time Element in Credit . . . . .	7
8.	Credit the Chief Medium of Exchange . . . . .	8
9.	How Credit Takes the Place of Gold . . . . .	9
10.	Bank and Government Credit Money . . . . .	10
11.	Other Advantages of Credit Over Gold . . . . .	11
12.	Difference Between Money and Credit . . . . .	12

### CHAPTER II

CREDIT, A BUSINESS BUILDER		
1.	Increasing the Working Power of Capital . . . . .	15
2.	Excessive Credit a Danger . . . . .	16
3.	The Merchant Who Does Not Use Credit . . . . .	18
4.	How Credit Helps the Manufacturer . . . . .	19
5.	Credit in Seasonal Lines of Business . . . . .	20
6.	Legitimate and Illegitimate Credit . . . . .	21
7.	"Goods for Goods" the Object of Trade . . . . .	22
8.	Credit Arising Thru Transfer of Goods . . . . .	23

SECTION	PAGE
9. Credit Expansion and Over-Production . . . . .	24
10. Credit and Panics . . . . .	25

## CHAPTER III

### DIVISION OF CREDITS

1. Varieties of Business Credit . . . . .	26
2. Personal Credit . . . . .	27
3. Abuse of Personal Credit . . . . .	28
4. Too Liberal Credit Harmful . . . . .	29
5. Mercantile Credit . . . . .	30
6. Present Credit System and Modern Trade Condi- tions . . . . .	31
7. Buying on Open Accounts . . . . .	32
8. Borrowing on Book Accounts . . . . .	33
9. Two Ways of Assigning Accounts . . . . .	34
10. Registration of Assigned Accounts . . . . .	35
11. Trade Acceptance . . . . .	36
12. Three Advantages of Trade Acceptance . . . . .	38
13. Practical Working of Acceptances . . . . .	39
14. An Approved Form of Acceptance . . . . .	39
15. Capital or Investment Credit . . . . .	40
16. Relation of Banking Credit to Commercial Credit	41
17. The Bank's Credit Latitude . . . . .	43
18. "Business Paper" and "Loans and Discounts" . . . . .	44

## CHAPTER IV

### FACTORS THAT DETERMINE CREDIT TITLE

1. Ability and Willingness to Pay . . . . .	47
2. Business Ability, Native and Acquired . . . . .	48
3. Technical Ability . . . . .	49

## CONTENTS

ix

SECTION	PAGE
4. Knowledge and Experience . . . . .	50
5. Buying Methods . . . . .	50
6. Manufacturing . . . . .	52
7. Equipment . . . . .	53
8. Advertising . . . . .	53
9. Location . . . . .	54
10. Age . . . . .	55
11. Evidence of Financial Ability . . . . .	56
12. Outside Ventures . . . . .	57
13. Distribution of Due Dates . . . . .	58
14. Cooperation with Mercantile Agencies . . . . .	58
15. Insurance . . . . .	59
16. Payment Methods . . . . .	59
17. Financial Strength . . . . .	60
18. Convertibility of Assets . . . . .	61
19. Liquidating Values . . . . .	62
20. Capital—How Acquired . . . . .	62
21. Moral Character in Its Relation to Credit . . . . .	63
22. The Customer Who Makes Unjust Claims . . . . .	64
23. The Good Moral Risk . . . . .	65

## CHAPTER V

### SOURCES OF CREDIT INFORMATION

1. Importance of Complete Information . . . . .	67
2. Overestimating the Value of References . . . . .	68
3. Five Important Sources of Credit Information . . . . .	68
4. The Property Statement: A Basic Consideration . . . . .	69
5. Growing Importance of the Property Statement . . . . .	70
6. Periodical Revision of Signed Statements . . . . .	71
7. Common Forms of Property Statements . . . . .	73
8. What the Property Statement Should Tell . . . . .	82
9. A Recent Statement Form . . . . .	82

## CREDIT AND THE CREDIT MAN

SECTION	PAGE
10. The Salesman as a Credit Reporter . . . .	83
11. The Traveling Credit Man . . . . .	88
12. Local Attorney as Credit Reporter . . . .	91
13. Law Lists and Free Attorney Reports . . . .	92
14. Banks as Sources of Credit Information . . . .	96

## CHAPTER VI

## MERCANTILE AGENCIES

1. Mercantile Agency Service . . . . .	98
2. How Mercantile Agency Information Is Collected	99
3. Contents of the Agencies' Reports . . . . .	100
4. Dun's and Bradstreet's Rating Books . . . . .	101
5. Special Credit Reports . . . . .	104
6. Trade Reviews and Market Conditions . . . . .	105
7. Cost of the Agency Service . . . . .	105
8. Special Trade Agencies . . . . .	105
9. Special Credit Agency in the Metal Trade . . . .	106
10. Special Agency in the Jewelry Trade . . . . .	109
11. Special Agency in the Furniture Trade . . . . .	110
12. Mercantile Agency in the Shoe and Leather Trade . . . . .	113
13. The Consolidated Building Trades Credit Associa- tion . . . . .	114

## CHAPTER VII

COOPERATIVE METHODS IN CREDIT  
INVESTIGATION

1. Credit Cooperative Methods . . . . .	116
2. Characteristics of Ledger Experience . . . . .	117
3. Procedure in the Exchange of Ledger Information	119

## CONTENTS

xi

SECTION	PAGE
4. Reciprocity a Necessary Element . . . . .	120
5. Operating Thru a Central Bureau . . . . .	120
6. Credit Clearing . . . . .	123
7. Inherent Defects of Credit Clearing . . . . .	123
8. The Credit Clearing House . . . . .	125
9. The Percentage System . . . . .	126
10. Giving Credit Advice . . . . .	127
11. A Probable Credit Interchange System of the Future . . . . .	128
12. A System Based on Abnormal Transaction . . . . .	130
13. Growing Recognition of Credit Interchange . . . . .	131

## CHAPTER VIII

### ANALYSIS OF CREDIT INFORMATION

1. The Financial Statement; Merchandise on Hand . . . . .	133
2. Notes and Accounts . . . . .	134
3. Cash on Hand or in Bank . . . . .	135
4. Fixtures, Machinery, etc. . . . .	136
5. Owing for Merchandise on Open Account . . . . .	136
6. Owing to Banks and to Relatives . . . . .	136
7. Outside Assets . . . . .	136
8. Analysis of Agency Reports . . . . .	137
9. Report on a Manufacturing Firm . . . . .	137
10. Analysis . . . . .	138
11. Report on a General Clothing Business . . . . .	141
12. Analysis . . . . .	143
13. Report on a Grocery Business . . . . .	144
14. Analysis . . . . .	146

## CHAPTER IX

### ANALYSIS OF CREDIT INFORMATION (*Continued*)

1. Report on a Dry-Goods Business . . . . .	148
2. Analysis . . . . .	149

SECTION	PAGE
3. Report on Boot and Shoe Business . . . . .	151
4. Analysis . . . . .	153
5. Advance Report and Salesmen's Data . . . . .	154
6. Analysis . . . . .	156

## CHAPTER X

### CREDIT PRACTICE IN REPRESENTATIVE LINES OF BUSINESS

1. General Observations . . . . .	160
2. Customary Credit Terms in the Grocery Business	161
3. Customary Credit Terms in the Meat and Provi- sion Business . . . . .	163
4. Customary Credit Terms in the Hardware Busi- ness . . . . .	164
5. Customary Credit Practice in the Boot and Shoe Business . . . . .	166
6. Customary Credit Terms in the Textile Business	168
7. Men's and Boys' Suits . . . . .	171
8. Customary Credit Terms in the Lumber Business	171
9. Customary Credit Terms in the Furniture Business	173
10. Customary Credit Terms in the Jewelry Business	173

## CHAPTER XI

### THE CREDIT MAN

1. Credit Man's Place in the Scheme of Business . .	175
2. The Question of Authority . . . . .	177
3. Attitude Toward the Customer . . . . .	178
4. Mental Qualities Desirable in a Credit Man . .	180
5. Moral and Social Qualities . . . . .	182
6. Special Training . . . . .	183

## CONTENTS

xiii

SECTION	PAGE
7. The Credit Man as a Business Force . . . . .	186
8. A "Business Service" Department . . . . .	188
9. Direct Value of Cooperation with Customer . . . . .	189

## CHAPTER XII

### WHY MERCHANTS FAIL

1. General Causes of Failure . . . . .	192
2. Business Mortality Statistics . . . . .	192
3. Chief Causes of Failure . . . . .	194
4. Lack of Enterprise . . . . .	196
5. Lack of Provision for Upkeep . . . . .	196
6. Poor Display of Goods . . . . .	197
7. Incompetent Clerks . . . . .	197
8. Wrong Buying . . . . .	198
9. Slow Turnover . . . . .	199
10. Liberal Credits and Poor Collections . . . . .	200
11. Inappropriate Advertising . . . . .	201
12. Defective Accounting Systems . . . . .	201
13. Figuring Profits . . . . .	203
14. A Common Error in Calculation . . . . .	204

## CHAPTER XIII

### CREDIT OFFICE ROUTINE

1. Essentials for a Credit System . . . . .	207
2. An Illustrative Method . . . . .	208
3. Requesting a Signed Statement . . . . .	209
4. Obtaining Advance Information . . . . .	210
5. Forms to Be Filled Out by Salesmen . . . . .	210
6. Handling New Orders . . . . .	211
7. Holding the Order Pending Investigation . . . . .	212

SECTION	PAGE
8. Final Disposition of the Order . . . . .	213
9. Color Keys in Credit Records . . . . .	213
10. Abstract of Financial Statement . . . . .	214

## CHAPTER XIV

### CREDIT PROTECTION

1. Efforts to Secure Protection . . . . .	216
2. Credit Insurance . . . . .	216
3. Arguments in Favor of Credit Insurance . . . . .	218
4. Arguments Against Credit Insurance . . . . .	219
5. The National Association of Credit Men . . . . .	221
6. Association Ethics . . . . .	223
7. Adjustment Bureaus . . . . .	224
8. Means of Recovery . . . . .	225
9. Unpaid Seller's Lien . . . . .	226
10. Stoppage in Transitu . . . . .	226
11. Reselling the Goods . . . . .	228
12. Recovery on the Ground of Fraud . . . . .	228
13. Steps in Litigation . . . . .	229
14. Importance of Evidence . . . . .	230
15. Enforcing the Judgment . . . . .	230
16. Exemptions . . . . .	231
17. Supplementary Proceedings . . . . .	231
18. Setting Aside Fraudulent Conveyances . . . . .	232
19. Bulk Sales Law . . . . .	232
20. Receivers . . . . .	233
21. Garnishment . . . . .	233
22. Attachment . . . . .	234
23. Imprisonment for Debt . . . . .	235
24. The Criminal Law as a Remedy . . . . .	235
25. Shall We Go to Law? . . . . .	236

# CONTENTS

XV

## CHAPTER XV

### BANKRUPTCY

SECTION	PAGE
1. Meaning of Bankruptcy . . . . .	238
2. Meaning of Insolvency . . . . .	238
3. Bankruptcy and Insolvency Laws . . . . .	239
4. State and Federal Laws . . . . .	240
5. Two Kinds of Bankruptcy . . . . .	240
6. Contents of the Petition . . . . .	241
7. Acts of Bankruptcy . . . . .	241
8. The Five Acts of Bankruptcy . . . . .	242
9. Provisional Remedies Pending Adjudication . . . . .	243
10. Trial and Reference of Proceedings to Referee . . . . .	244
11. Meetings of Creditors . . . . .	244
12. Trustees in Bankruptcy . . . . .	245
13. Duties of Bankrupt . . . . .	246
14. Schedules . . . . .	246
15. Valid, Provable and Allowable Claims . . . . .	247
16. Valid Claims . . . . .	247
17. Provable Claims . . . . .	248
18. Allowable Claims . . . . .	249
19. Voidable Preferences . . . . .	250
20. Priority of Debts in Distribution of Bankrupt's Estate . . . . .	250
21. Dividends in Bankruptcy . . . . .	251
22. Composition with Creditors . . . . .	252
23. Discharge of Bankrupt . . . . .	253
24. Debts Not Discharged in Bankruptcy . . . . .	253
25. Advantages of Bankruptcy Act . . . . .	254
26. Canadian Practice . . . . .	254
27. Procedure . . . . .	255
28. Fraudulent Conveyances and Transfers . . . . .	256
29. Fraud by Insolvent Traders . . . . .	257
30. Winding up of Companies . . . . .	258

SECTION	PAGE
31. Insolvency of a Company: Law Determined . . . . .	259
32. Duties of Liquidator . . . . .	260
33. All Claims May Be Proved . . . . .	260
34. Bulk Sales . . . . .	261

## CHAPTER XVI

### CREDIT MANAGEMENT OF RETAIL STORES

1. Effect of Credit in Retail Selling . . . . .	262
2. Customer's Credit Title . . . . .	264
3. Two Important Estimates . . . . .	266
4. Discrimination in Credit-granting . . . . .	267
5. Understanding as to Terms . . . . .	268
6. Opening an Account . . . . .	269
7. Corroborative Information . . . . .	271
8. Watching the Account . . . . .	273
9. Credit Interchange Among Retailers . . . . .	273
10. Two Systems . . . . .	275
11. Rating Blanks . . . . .	276
12. A Typical Credit Bureau . . . . .	277
13. A Unique Credit Bureau . . . . .	278
14. Instalment House Credit . . . . .	280
15. Points to Be Observed . . . . .	281
16. An Element of Danger . . . . .	284

## CHAPTER XVII

### THE COLLECTION DEPARTMENT

1. General Collection Principles in a Wholesale House . . . . .	286
2. Three Causes of Delinquency . . . . .	288
3. The Monthly Statement . . . . .	289

## CONTENTS

xvii

SECTION	PAGE
4. The Collection Letter . . . . .	290
5. A Letter with a Notice of a Draft . . . . .	292
6. When the Draft Is Ignored . . . . .	294
7. Taking Legal Proceedings . . . . .	295
8. A Choice of Methods . . . . .	296
9. A Wrong Mental Attitude . . . . .	298
10. Use of the Collection Agency . . . . .	299
11. The Adjuster . . . . .	300
12. Taking Unearned Discounts . . . . .	301
13. Changing Interest on Deferred Payments . . . . .	303
14. Defective Remittances . . . . .	304

## CHAPTER XVIII

### THE COLLECTION DEPARTMENT (*Continued*)

1. The Commercial Lawyer . . . . .	307
2. Acknowledgment and Report . . . . .	309
3. Justices and Collectors . . . . .	310
4. The Collection Agency . . . . .	311
5. Procedure in Forwarding Claim . . . . .	312
6. Reporting to Client . . . . .	313
7. Agency's Record Correspondence . . . . .	314
8. Collection Agency Drafts . . . . .	316
9. The Fake Collection Agency . . . . .	317
10. Collection Fees . . . . .	317
11. Extra Collection Fees . . . . .	319
12. Assisting the Attorney . . . . .	320

## CHAPTER XIX

### RETAILERS' COLLECTION METHODS

1. General Principles . . . . .	322
2. Prevailing Collection Policies . . . . .	323
3. Importance of Correct Initial Attitude . . . . .	324

SECTION	PAGE
4. The Apologetic Attitude . . . . .	327
5. A Correct Collection Attitude . . . . .	328
6. Sending the Collector . . . . .	328
7. Instalment House Collection . . . . .	330
8. Piano Collections . . . . .	331
9. Reaching the Turning Point . . . . .	333
10. Collecting for Service Rendered . . . . .	334
Index . . . . .	337

# CREDIT AND THE CREDIT MAN

## CHAPTER I

### NATURE AND FUNCTIONS OF CREDIT

1. *The magic of credit.*—That credit is a force in modern business requires but little proof in view of its extensive use by merchants and manufacturers the world over. That, as a matter of fact, it is an indispensable element in present-day commerce, will also readily appear upon even a cursory examination of the subject. That some of the feats performed by credit are remarkable to an extent approaching the work of a magician upon the stage, is likewise subject of proof.

To illustrate the last statement: A merchant in Chicago wishes to import a shipment of goods from a manufacturer in Yokohama, Japan. He is not willing, however, to pay for these goods in advance; in fact, he wishes to pay for them only after he has received them and has had an opportunity to re-sell them to his customers. But the Japanese manufacturer insists upon receiving payment before the steamer upon which he is to ship the goods leaves port. Inasmuch as it might take two months before such a shipment

could be delivered in Chicago, and since another month or two might be required for the resale of the goods and for the money to reach the Yokohama manufacturer, probably four months would elapse before the transaction as a whole could be closed. It is evident, therefore, that the conditions imposed by the shipper on the one hand and the importer on the other, cannot be complied with—unless, indeed, the latter borrow the required amount of money.

Credit, however, overcomes the difficulty. A simple letter of credit, obtained by the Chicago merchant from his local banker, permits the Yokohama manufacturer to make a four months' draft upon a London bank, which draft he may sell to his Yokohama banker even before the ship that carries his goods has started on its voyage to the United States. The Yokohama bank in turn may promptly resell the draft to a local merchant who has bills to pay in London. Upon presentation in due time of the draft at the London bank, the latter, with a stroke of the pen "accepts" the document, which thereupon circulates in the credit market until the four months have just expired, when it is again presented—this time for payment. But long ere that date arrives, the goods from Japan will have arrived in Chicago and will in all probability have been resold by the importer. A sufficient part of the proceeds of the sale will also have been sent to the London bank, so that the latter, when the draft reappears, is ready to pay it without having to use any of its own money.

Thus, without any one having advanced a penny, the transaction has gone thru without a hitch. The money which the Chicago importer paid for the Japanese shipment was received by the shipper four months before that money was sent. Yet the importer sent the money only after the goods had been received in Chicago and resold there. Credit, as we see, has performed the apparently impossible!

2. *Meaning of credit.*—It is natural that in beginning our study of this exceedingly important factor of modern commerce, we should seek to obtain a clear and comprehensive understanding of the meaning of the term itself. In a general way, of course, every one is familiar with the term “getting credit” or “buying on credit.” We know that ordinarily it describes the obtaining of something in the present for which payment is to be made in the future. Yet for our present purpose we need a somewhat fuller and more exact understanding of the subject than this general concept affords.

Numerous definitions of credit have been given, each differing more or less from the others, according to the special viewpoint of the defining authority. Thus, one definition tells us that credit is “a reputation of character, of confidence or trust, a good name or opinion gained by upright conduct in business; a reputation of solvency.” Another definition, equally correct, says that credit is “the present right to a future payment.” It is easily recognized that both definitions are right as far as they go; yet they are

necessarily incomplete in that each regards the subject from only one point of view. We shall probably obtain a clearer idea of the subject, as far as our present inquiry is concerned, if we consider briefly the place of credit in our modern commercial structure. We may, therefore, defer for the moment any attempt to supply a more comprehensive definition.

3. *Relation of credit to capital.*—When wealth, or any part of it, is employed for productive purposes, as in manufacturing or similar enterprises, it is called capital. Unless it is employed productively, wealth is not, properly speaking, capital. When hoarded or otherwise permitted to be idle and unproductive, it is not regarded as capital.

Credit is not a product of labor and is not capital. It is important that we be clear as to that from the outset. We shall presently note more fully what credit accomplishes in the world of trade, and shall then be better able to appreciate the fact that whatever else credit may be in an economic sense, from the standpoint of the merchant, credit may properly be regarded as machinery invented to aid in accomplishing the purposes of capital.

4. *Credit and civilization.*—Going back a little, we note that credit did not obtain its present importance all at once. It has been a plant of slow growth. Credit is, in fact, both a promoter and a result of civilization, and its development is found to have kept pace with the development of civilization, which fact suggests that as time goes on still further refinements

and extensions in the profitable use of credit may be possible.

In the earliest times of man's existence credit was probably unknown. For as long as might was right, the stronger possessed himself at will of the property of the weaker, and since under such conditions the question of payment did not arise, there could be no occasion for the use of credit. Gradually, however, the law of might gave place to the law of right, and instead of possession by conquest, there came to be possession by exchange. For the thing wanted, another thing of equal value was tendered, and if the exchange was mutually satisfactory, the trade was consummated.

But exchange in the form of barter is necessarily crude and cumbersome, and seldom wholly satisfactory. Hence the demand for a medium of exchange arose. Something was needed that could be passed from hand to hand at a fixed value and into the terms of which other values could be readily translated.

A variety of commodities came to be used for that purpose. It is interesting to recall that no farther back than the Colonial period of our country, tobacco was used as currency, and for nearly two hundred years the State of Virginia grew its own money. Maryland did the same for a somewhat briefer period.

Finally, as we know, gold and silver became the preferred money metals. In the course of time, however, a point was reached where even a material medium of exchange, such as gold, proved inadequate

for the purpose of a ready exchange of goods and services. For that reason, and for others which will come before us presently, credit came to be recognized as a legitimate and desirable factor in trade, and began to take the place of money as a medium of exchange in business transactions.

5. *Place of confidence in credit transactions.*—With the gradual progress of civilization men learned to trust each other, and out of this increasing confidence of man in his fellow-man the use of credit was gradually developed.

Without such confidence there could of course be no credit, for altho, as we shall presently see, confidence is not the sole basis of our credit system, it is nevertheless indispensable to the existence of credit relations. "Credit cannot exist," as one writer has well said, "without confidence in the security of property and in the disposition of the purchaser of a commodity to pay for it at the time appointed. No man parts with his property except when he believes an equivalent will be returned."

6. *Confidence supported by contract.*—It is clear, however, that if the requirements of business make it necessary that men trust each other, it is equally necessary that some means be found for protecting this confidence and preventing its abuse. The law of contract has come to us as a result of that necessity. As the lawyer would express it: "The growth of civilization is the development of man from a condition of status to a condition of contract." Earlier

conditions permitted every man to carry on his way of making a living with the assurance that as long as he observed the common usages of the locality in which he lived, his status or economic relation with other men would be duly protected. Hence, we find that men paid customary rent for their land, received customary wages for their labor and charged customary prices for their products. In fact, business relations of every kind were regulated wholly by the customs which earlier generations had established.

Later we find that men entered into agreements with each other whereby they pledged themselves to perform some act in the future. And since the element of future time entered more and more into men's business relations, it was seen to be necessary that the confidence upon which these relations rested should be protected against abuse. It is for this reason that the fundamental law of the business world is one that punishes severely every act whereby the obligations of a contract are disregarded. So closely associated have the two ideas of confidence and contract become that they are often expressed in a single word—credit. From a legal viewpoint credit has been defined as a "right of action."

7. *Time element in credit.*—Just as in all credit transactions confidence is an essential factor, so is time an ever-present element. To illustrate: A retail merchant buys from his wholesaler a bill of goods amounting to \$1,000. If payment were demanded on delivery of the goods, the merchant, perhaps, could

not pay for them. If, on the other hand, the wholesaler consents to wait thirty or sixty days for his payment, it will be possible for the retailer to resell the goods, or at least a considerable part of them, before the wholesaler's bill falls due. Thus it becomes possible to earn a profit by the resale of goods for which payment has not yet been made.

This, as will appear more fully later, is just the purpose for which commercial credit is sought and given. To this end a credit of thirty, sixty, or ninety days, and sometimes of even a longer period, is given, the credit terms being governed by the nature of the goods and by the customs that prevail in the particular line of trade. If the buyer, instead of holding off payment until the expiration of the credit period, completes the transaction by paying his bill within a certain shorter period, he usually receives a special discount called a cash discount. This cash discount in most cases applies to payments made within ten days of the date of invoice, altho there are not a few exceptions to this rule.

8. *Credit the chief medium of exchange.*—Since with the increase and development of business, the inadequacy of money as a medium of exchange became more and more evident, credit gradually assumed a more and more important place as such medium in the settlement of business transactions. This development has now reached a stage where all but a small fraction of the world's business is transacted with credit as the medium of exchange, tho all

such transactions are necessarily measured and recorded in terms of money.

So important, in fact, has this function of credit become that any attempt to dispense with it at this late day would prove disastrous not only to business, but to society at large. If we may conceive a situation in which credit was eliminated and the substitution of cash payment enjoined, we should find the gigantic machinery of the world's trade rapidly coming to a standstill. Under such conditions industry and enterprise could not exist. Untold and widespread suffering and death would follow, and man would quickly relapse into a state of semi-savagery. So integral a part of our social system is credit at the present time.

In the oft-quoted words of Daniel Webster:

Credit is the vital air of modern commerce. It has done more, a thousand times, to enrich nations than all the mines of the world. It has excited labor, stimulated manufactures, pushed commerce over every sea, and brought every nation, every kingdom, and every small tribe among the races of men to be known to all the rest: it has raised armies, equipped navies, and, triumphing over the gross power of mere numbers, it has established national superiority on the foundation of intelligence, wealth and well-directed industry.

9. *How credit takes the place of gold.*—As already mentioned, the world's gold supply is wholly insufficient to meet the demands of trade even if it were used for nothing else. For the purpose of settling trade transactions, therefore, recourse is had to bills of exchange, notes and checks—commonly spoken of

as instruments of credit. Instead of handing his jobber, say, \$100 in gold in payment of a bill of merchandise, the retailer may offer a piece of paper containing merely a promise to pay a certain sum at some definite future date—a promissory note. This paper, if confidence is had in the ability of its maker to fulfil his written promise, assumes for the purpose of payment all the importance and value of the gold which it promises to pay. Like money it may be passed from hand to hand, each recipient using it in paying his bills.

The paper may be an order upon the drawer's bank account—a depositor's check. For ordinary purposes of trade, such a check is just as good as the money it represents. The one who receives it, instead of taking it to the maker's bank and there exchanging it for its face value in gold, simply writes his name across the back of it and deposits it in his own bank, subsequently drawing his check against it. Or he may, after thus indorsing it, turn it over to some creditor, precisely as though it were actual money.

Again, the paper may be a draft—an order upon some person in a distant city, directing him to pay to the person named in the order as payee a certain sum.

As media of exchange, these various forms of credit instruments are, under proper conditions, equally serviceable.

10. *Bank and government credit money.*—Possibly the paper, instead of being a privately issued credit

instrument, is a bank note issued by a national or federal bank, promising to pay on demand an equal sum of gold. But no one into whose hands such a bank note falls thinks of taking it to the issuing bank to redeem it in gold. He simply regards it as "money" and proceeds to use it as such. He knows, of course, that the government has safeguarded such bank notes by means of compulsory deposits of first-class securities, and that therefore the risk he is assuming is wholly negligible.

Once more the credit paper may be one that is issued by the government itself. It may be a "gold certificate," entitling the holder to an equal amount in gold whenever he presents it at the treasury department for payment. But in ordinary times at least, this bit of paper is worth for purposes of trade every cent of the amount printed on its face, even tho intrinsically of no value whatever.

As long, therefore, as such "promise-to-pay" paper is accepted and passes current in trade for the liquidation of debts, this medium of exchange is sufficient to effect the settlement of trade balances the world over. The relation of credit to gold and its regulation by the government are interesting and important subjects, but do not come properly within the scope of our present inquiry.

11. *Other advantages of credit over gold.*—Suppose a million dollars were to be sent from San Francisco to New York in settlement of a trade obligation. Suppose, also, that this amount in gold were

on hand and available for the purpose. It would be possible, of course, to pack and box the gold securely and to send it by express train across the continent. Yet to do so would be both troublesome and expensive. It would furthermore entail considerable risk. The loss of interest, while the gold was en route and thereby withheld from the channels of trade, would add to the cost of transportation, especially if delays occurred.

In order to avoid all this risk of loss and delay, and for the purpose of saving all but a small part of the cost involved in such shipment, credit is summoned to the shipper's aid. A bill of exchange on New York for the amount to be transferred is obtained without difficulty and promptly deposited in the mail. In a few days the creditor will have received the amount at the bank in New York—not in gold, to be sure, but in credit. Yet his account in the bank will be credited with the amount transferred, just as tho the gold itself had actually been received, and the whole transaction, as far as he is concerned, is thereby closed.

When large amounts are to be sent abroad—perhaps to some far-away country where the shipment of gold would be attended with even greater risk and difficulty than in the case cited—the use of credit instruments instead of gold is, of course, all the more convenient.

12. *Difference between money and credit.*—But while credit as a medium of exchange now performs

the greater part of that work which formerly was allotted chiefly to money, it is important to note that credit itself is not, under any circumstances, money. The latter, being wealth, possesses value. The metal in a five-dollar gold piece is worth approximately \$5. It may be melted or hammered into any shape, yet merely as a slug or piece of gold, whatever its form, it is worth and can be sold for the same amount. Credit, on the other hand, is merely an evidence of debt and obtains its commercial value solely from that fact. This is shown by the fact that when times are hard and a financial panic threatens, credit is unable to satisfy the existing needs of the commercial world. At such times there is already too much credit in existence. Any attempt to increase that amount, instead of relieving the tension, only adds to the existing danger and distress. In the confusion which always exists during a panic, every one is clamoring for money. Credit is abundant in the form of evidence of debt; money, that is, gold, is correspondingly scarce. It is, in fact, just because such evidences of debt, or credit obligations, cannot be liquidated in gold on demand that the panic occurs.

In the same way, the paper currency of a country is good only so long as the government is able to redeem it in gold upon demand. When conditions make this impossible, the paper currency (government credit) quickly declines in value.

## REVIEW

In the transaction between the American importer and the Japanese manufacturer, told in this chapter, who furnished the money with which the latter was paid?

What is your understanding of the statement that credit may be regarded as machinery invented to aid in the purposes of capital?

Why would the sudden withdrawal of all credit necessarily plunge the civilized world into confusion and distress?

Since credit is even more important than gold as a means of canceling debts, why may we not say that credit is money?

## CHAPTER II

### CREDIT A BUSINESS BUILDER.

1. *Increasing the working power of capital.*—We have already noted that credit, by reason of its suitability as a medium of exchange, makes it possible for commercial transactions to be carried on with much greater ease and freedom than when settlements are required in goods or money. Another and equally beneficial service rendered by credit is that it permits the merchant to increase the working power of his capital. With a capital of \$10,000 he may readily be able by means of credit to do a business involving the use of \$20,000. Accordingly part of his profits would be made from the use of money not his own. The \$10,000 belonging to his creditors would be made to yield him a profit just as if that sum were his own. Under favorable circumstances that part of his working capital which belongs to his creditors may even be much the larger of the two.

It is evident that when a manufacturer or wholesaler places a quantity of his goods in a retail dealer's hands he virtually gives him the use of his capital to that extent for the period of the credit term, whether this be one of thirty, sixty or ninety days. To the retail merchant this means much more than

the value of money as measured by the usual interest rate. In other words, if money may be borrowed from the bank at an annual interest rate of, say, five per cent, the value of the credit which the merchant obtains from the wholesaler is normally much greater. For, as already pointed out, by means of such credit the former makes a merchandising profit upon the capital employed—generally more than double the amount of the banking rate of interest.

2. *Excessive credit a danger.*—We must not conclude, however, from the foregoing that by increasing his credit indefinitely the merchant also necessarily increases his profits. Credit in his case, in order to be beneficial, must bear a fixed relation to the volume of business permitted by local conditions. If, for example, the character of the business, the neighborhood in which the store is located, or other causes restrict the possible volume of business to a certain amount, it is evident that no additional amount of credit extended to that dealer will make it possible for him to sell more goods. If used beyond a certain point, credit, instead of remaining a friend and helper, may become not only a useless burden, but a foe and at times even a destroyer. Unless the merchant possess sufficient business capacity to determine in advance, and with reasonable accuracy, the total volume of his annual sales, and unless he is able to proportion that volume rightly among his various departments, he is in danger of being misled by alluring offers of credit and as a result may overstock him-

self with goods which for the time being, at least, he will be unable to sell.

This condition results in the tying up of capital and credit where these are unable to serve him, thereby diminishing his active resources in an equal amount and placing additional burdens upon the remainder of his capital. Frequently these burdens become too heavy for their weakened support, so that when accounts mature and payments are demanded, sufficient funds are not at hand to meet them. A state of delinquency is the result. Presently, unless in some way the burden is lifted, the delinquency spreads to accounts with other creditors, and before long a state of insolvency is induced, compelling creditors for their own protection to step in and demand an adjustment of the dealer's affairs, either with or without his consent and cooperation. For this reason overbuying, by which is understood buying in excess of the actual demands of his trade, is one of the greatest dangers to which the average retail merchant is exposed. Against this danger every properly conducted wholesale and manufacturing concern is constantly on the watch.

Where, on the other hand, the dealer's situation is one in which a larger volume of business could be done provided additional capital were available for purposes of increasing stocks of salable merchandise, the employment of additional credit is not only in itself perfectly legitimate but also distinctly profitable to both dealer and supply house.

3. *The merchant who does not use credit.*—Consistently with the foregoing, the merchant who “doesn’t owe a dollar in the world” is not ordinarily making the best use of his opportunities, and is not, therefore, regarded as conducting his business upon approved lines of good merchandising. For a dealer may have too much capital invested in his business for his own good, just as he may have too little. It is hardly necessary to point out that the dealer with insufficient capital is handicapped at every turn. A respectable percentage of business failures is attributed to that very condition. Such a dealer cannot buy in sufficient quantities to obtain the lowest prices; he cannot carry customers who require liberal credit accommodation; he cannot take advantage of cash discounts and bargain offers such as are often made by manufacturers at certain seasons of the year. With him the problem of meeting his obligations on time is an ever-present and difficult one. Unless indeed he possesses conspicuous business ability, such a dealer, tho he be perfectly honest, is not a safe credit risk.

On the other hand, the dealer who uses twice as much of his own capital in his business as is actually necessary, and who fails to avail himself of the opportunity to make use of his creditors’ capital, or of capital furnished by the bank, in the amount to which he is properly entitled, is necessarily depriving himself of the profits which an outside investment of his surplus capital might bring him. While for a time the dealer with too much capital is admittedly a safer

credit risk than one with too little, this condition may readily reverse itself, especially if the former has competitors who employ sound merchandising and credit principles, and also use aggressive business tactics.

4. *How credit helps the manufacturer.*—Another instance of the benefits of credit for purposes of business extension is where a manufacturer has sold his output of goods to wholesalers or jobbers on usual credit terms of, say, sixty days, and where this output represents practically all the manufacturer's available capital—a condition not uncommon among small manufacturers. Under the circumstances, if he had to pay cash he would not be able either to buy the necessary raw material or to enlarge his factory in order to take care of an expected increase in orders. He might not in fact be able to continue the production of additional goods until the goods sold had been paid for. At the same time he could not well afford to let his plant be shut down or his men remain idle for sixty days while he waited for his customers to settle their accounts. He would need the use of his money at once.

Thru the good offices of credit the manufacturer is able to repossess himself of his capital without any delay. The bank, which is primarily an institution for the purchase and sale of credit, stands ready to buy, with certain safeguards, the manufacturer's right to demand payment from his customers in sixty days. In payment for this right the bank in turn gives the

manufacturer a right to use its—the bank's—credit in an equal amount, less the interest charge for the intervening period. The bank may, of course, if requested to do so, pay to the manufacturer the amount in gold. Usually, however, it merely credits the amount on its books to the manufacturer's account. But for the manufacturer's purpose the bank's credit, which he thus obtains, is just as useful as the gold which it represents, since with the aid of that credit he may at once resume his productive activities, buy raw material and pay his workmen's wages, exactly as tho his customers had paid him cash for their purchases.

5. *Credit in seasonal lines of business.*—Again, the manufacturer may have a large quantity of goods made up in readiness for the coming season's business. This is a condition which obtains, for example, in the toy business, where the selling season is very brief and commences only about two or three months before the Christmas holidays. In that case, since the larger part of the manufacturer's capital will probably be represented by his stock on hand, the services of credit may be greatly needed. As in the previous case, the banker is ready, upon proper investigation of the circumstances, to extend the required credit accommodation, and the manufacturer is able once more to utilize the capital which, without the services of credit, would remain locked up in the manufactured product while this was awaiting the season's sale.

The foregoing instances are sufficient to point out, in a general way, the nature of the services which credit is capable of rendering to the business world—that, namely, of making the capital of others available in the present, when one's own command of capital lies in the future.

6. *Legitimate and illegitimate credit.*—The observation already made enables us now to distinguish between what may be termed legitimate and illegitimate credit. In the first place, only such credit is legitimate as permits larger profits to be made than would be possible without it. When a point is reached where the use of additional credit adds nothing to profits, credit ceases to be legitimate. The economic law of diminishing returns applies just as much to that non-material substance which we call credit as it does to land or capital. In the second place, credit, in order to be legitimate, must be based upon goods in possession. This statement may call for a word of explanation.

We have already noted that confidence is necessary to the existence of credit. So interwoven, in fact, are the two terms that at times they are used interchangeably. But when we come to look at the subject from what might be called its economic side, we discover that credit—legitimate credit—rests upon a foundation somewhat more tangible than mere confidence or trust. This foundation is goods—salable goods. It is necessary that for every dollar's worth of credit there be an equivalent in goods to

give it legitimacy. Where this is not the case, credit is illegitimate and as such lacks the right of existence.

7. "*Goods for goods*" the object of trade.—The foregoing remarks will, perhaps, be more readily understood if we remind ourselves that the ultimate object of trade is invariably the exchange of goods for goods. Money is never the real object of trade: it is, as we know, merely the medium of exchange by means of which goods are moved from seller to buyer and in the terms of which their value is measured. The various human wants cannot be satisfied with money. Man needs food, clothing, shelter, implements, etc., to which may be added the wants created by modern civilization—comforts and luxuries which, altho not indispensable, nevertheless contribute materially to man's well-being and happiness. Money is valuable only as it facilitates the satisfaction of these wants.

Further proof is hardly needed to show that credit rests upon goods and that the ultimate object of trade is goods, not money. The foregoing observations relate not only to the trade of a particular section or territory or country, but to that of the whole world. For every debit there must be a credit. The world's sales and purchases must necessarily balance. For every dollar's worth of goods exported from a country, an equivalent of goods, or title to goods, must be received by that country. In view of this fact, it is evident that what is chiefly needed in order to facilitate such exchanges, is a system whereby these sales and purchases may be "cleared" or set off

against one another on the principle employed by the banks of a city whereby these daily "clear" each other's checks received in the previous day's business. And precisely as a large amount of checks may thus be exchanged without the use of other than a very small amount of money, so may also the world's sales and purchases, however large, be set off against one another by means of a suitable and adequate credit system.

8. *Credit arising thru transfer of goods.*—We should note, however, what for our purpose is straight to the point, that it is the process of transferring goods from seller to buyer that makes a medium of exchange necessary. Credit comes into being by the shipment of goods; it is measured by the invoice value of the goods expressed in terms of money, and is extinguished when—perhaps months later—an equivalent in exchangeable goods (which may include gold) is rendered the creditor.

The economic basis of credit is thus seen to be goods, just as the movement of such goods between seller and buyer furnishes the occasion for the creation of credit. But as soon as the volume of credit exceeds the value of salable goods, a false condition is created; and credit thereupon becomes illegitimate. In times of prosperity a strong tendency always exists to carry credit beyond its proper limit. For a while this condition may not be apparent and no evil results may reveal themselves; but sooner or later the true condition becomes manifest, and then

things begin to go wrong. That is why business depression always follows a season of marked prosperity. So regular, in fact, are these "swings" of prosperity and depression that the time of their appearance may generally be foretold with a fair degree of accuracy provided a little study be given to their history and periodicity.

9. *Credit expansion and over-production.*—It is a fact often observed that over-expansion of credit causes over-production of goods. This happens because the increased purchasing power created by such over-expansion of credit in turn gives rise to an artificial demand, as a result of which prices go up. When the time of settlement comes, it is discovered that production is greatly in excess of the actually existing demand. When this point is reached, prices generally come tumbling down, often falling to a level considerably lower than that of a normal valuation. At such times credit, too, suddenly contracts. Capital likewise is withdrawn, and a slow and painful process of readjustment begins to take place. Only gradually are normal trade conditions restored.

Henry D. Macleod, the English writer, describes this process as follows:

All commercial crises originate in the over-creation of credit, and this is innate in the modern system of credit. Suppose that at any time the commercial world started with a perfectly clean slate. When such multitudes of persons are trading on credit, it must inevitably happen that a considerable number will speculate unsuccessfully and create an excess of credit, which cannot be redeemed by fair means.

All excess of credit may be considered as so much virus or poison in the body commercial. However, by various tricks and devices known to traders, they can keep themselves afloat many years after they are utterly insolvent; and thus the poison continually accumulates. Then, perhaps, a fever of speculation takes place, giving rise to the creation of vast masses of speculative paper, and then the poison, having accumulated to a sufficient extent, bursts forth in a tumor or abscess, called a commercial crisis.

10. *Credit and panics.*—Nearly all business failures are caused by illegitimate credit. Every financial panic has its origin in the same evil. But legitimate credit, let it be noted, no matter how extensive it may be, can never be an evil. It can never cause a panic. It will never clog the wheels of commerce, or induce a business depression. On the contrary, such credit acts as oil upon the machinery of trade; it keeps business transactions moving smoothly and expeditiously. The more perfect a country's credit system the more remote is the probability of a financial panic.

## REVIEW

At what point in the development of a business will the use of additional credit prove excessive, hence unprofitable, and eventually injurious?

Why is it ordinarily more profitable for a merchant to do business on part borrowed capital than on capital all his own?

How does an over-expansion of credit produce a financial panic?

What is the ultimate test as to the legitimacy or illegitimacy of a credit extension?

## CHAPTER III

### DIVISION OF CREDITS

1. *Varieties of business credit.*—It was shown in the first chapter that barter, money and credit represent three stages in commercial development, differing primarily in the degree of confidence in business relations which each implies. Such confidence is most marked in the last stage, or credit economy, since the very essence of our present commercial system consists in the time element in business transactions. All but a small fraction of modern business is done on credit. The longer the lapse of time from the surrender of one's property until payment is received therefor, the greater is the confidence in one another displayed by the parties.

Nevertheless, there is a definite relation between the present-day credit economy and the use of money, inasmuch as every credit instrument given in exchange for goods is a promise to pay money and must be capable of liquidation by means of money.

For this reason the commercial world is compelled to watch both the character of the collateral, and the condition of the money market. The credit must be based on marketable goods or collateral that will not

have declined in money value when the end of the credit period shall have been reached.

When we speak of personal credit, banking credit or mercantile credit, we do not mean that the transactions to which these terms refer differ in their nature, but simply that they occupy different positions in the field of business relations. It is evident that a bank, a large commercial house, and a small retail store may all on the same day receive requests for credit, and that the same kind of security may be offered in each case; yet inasmuch as there would be different relations established, different names would be used in designating them. Therefore, while certain cases are common to the whole field of credit operations there are certain lines of credit which must be considered under the various titles by which they are commonly known.

2. *Personal credit*.—The first kind of credit to come into existence was personal credit. Borrowing arose from a desire to obtain present possession of goods for personal uses at times when means of payment were not available. Later on, however, when man was not satisfied with making a living but insisted upon making a profit, other forms of credit, namely, banking and commercial credit, came into existence.

But altho personal credit is the oldest, the granting of such credit is not systematically organized. This fact need occasion no surprise, however, if we take into account the conditions under which such credit is

usually granted. For each separate extension of such credit is made to an individual member of society whose relation to others, in his capacity as an individual consumer, is not placed on record by means of public ratings of his capital or character, as is the case with the applicant for commercial credit. The great differences in the economic status of those who wish to buy on credit goods for their own consumption, render almost impossible the establishment of a uniform credit policy on the part of the dealers from whom they buy.

But the lack of system which generally exists in this branch of credit is not explained altogether by the theory of a difference in economic standing on the part of consumers. To some extent, at least, the dispensers of credit are themselves at fault. The late J. G. Cannon, former president of the Fourth National Bank of New York, observed some years ago, in a paper entitled "Individual Credits," that one of the great evils connected with personal credit is "too great liberality." While this is undoubtedly true, yet it should be noted that such liberality is not an expression of benevolence or kindred sentiment on the part of the credit-giver, but rather the direct result of ignorance or carelessness on the part of those whose duty it is to investigate fully the credit title of each applicant for personal credit.

3. *Abuse of personal credit.*—The injudicious extension of personal credit has a twofold effect—an influence upon the commercial system as a whole and

an influence upon prices. For if the retail merchant cannot collect his debts when these are due, he may be compelled to ask the wholesalers from whom he buys his goods to wait for payment. Producers and manufacturers, therefore, are compelled to suffer the restrictions that are put upon their business activities by failure to meet their obligations promptly and sometimes by fraud on the part of their customers. Ultimately, of course, the penalty for all this looseness with regard to the observance of credit terms is paid by the consumer in the form of increased prices. This is made necessary because the commercial world must assume the added risk of bad debts.

4. *Too liberal credit harmful.*—The burden which a community must bear as the result of too liberal extension of personal credit is not wholly limited to the higher prices for commodities. It includes also the presence of many persons who are chronically impoverished through the reckless buying of too many articles or goods on credit. Among those who avail themselves of such credit are many persons who give no consideration to the probable demands of the future, but are governed in their purchases solely by present desire. In every section of the country there are those who have made no provision for old age or for periods of idleness or sickness.

Where principles of frugality have not been inculcated, the temptation to buy beyond one's means is always strong, even tho, as is frequently the case, the article bought lacks the ordinary elements of use-

fulness or suitability. In a report upon the conditions of some of the southern cotton mills, mention is made of the prevailing habit of the operatives to buy on credit such things as highly colored pictures, jewelry, articles of finery, etc., tho as a consequence they suffer for want of many of the actual necessities of life. It is beyond dispute that in such cases the granting of credit is distinctly harmful; yet, let it be noticed, it is the abuse of credit—not its proper use—that is here exemplified.

5. *Mercantile credit*.—Naturally we may expect to find a more highly developed credit system in connection with these larger transactions.

Since mercantile credit applies to all those trade interchanges which relate to the distribution of goods, the latter function includes so many and such varied credit operations that special institutions and agencies have had to be provided in order to facilitate such operations and make them safe. Banks, brokerage houses and commercial agencies are among the institutions that have been called upon for help in effecting such transfers of goods.

The mercantile credit system of today has been developed slowly and according to the demands of trade. As commerce grew, the entire system of distribution gradually underwent a transformation. With the development of the country westward and southward, new conditions of distribution arose, owing to the widely separated markets. As the distance grew between producer and consumer the risk in-

volved in credit sales also grew, while the difficulty of adjusting present and prospective resources to the present and prospective needs for an increasing number of communities made itself increasingly felt. This was true of local, national and international markets.

The modern mercantile credit system may be said to be complementary to the commercial system, since the former adjusts itself to the latter and thereby protects it. In the West and South the new communities needed capital with which to develop their natural resources. By means of credit they were enabled to overcome the difficulties which confronted them in the beginning of their enterprises. At that stage a tendency to speculation developed in their midst, at times sweeping over an entire community. However, as they gradually acquired a more settled condition, these communities learned to abandon their speculative tendencies and to be more conservative in their commercial transactions.

6. *Present credit system and modern trade conditions.*—As a direct result of improved trading conditions the character of the credit system also underwent certain important changes. Formerly it had been necessary for the manufacturer and the wholesaler to sell on long credit terms. For that reason they were generally compelled to require payment by promissory note at the time of shipment, in order that by discounting such notes at the bank they might assure themselves of being in capital funds during

the period when their goods were being sold by the retailer upon the prevailing long credit terms. Under the improved facilities of communication, however, the former long-time commercial paper rapidly gave way to short-time payments on open account.

In addition to the services which the railway, the mail, the telegraph and the telephone have rendered credit transactions, these have been further helped by the increase in banking accommodations which are now found in nearly every town and village in the country. These accommodations have worked a change in the methods and extent of note settlements. The long-time credit—frequently one of six months or a year—was of course paid for by the merchant in the form of higher prices and higher rates of interest. When, therefore, he found that the bank was willing to extend to him the necessary accommodations, he quickly saw the wisdom of borrowing money from the bank and taking advantage of the wholesaler's most favorable credit terms.

7. *Buying on open account.*—With the practically complete disappearance of the long-time credit instrument, the chief record of credit transactions was that which the creditor's books contained. The bills of exchange formerly used had not only served as first-hand evidence of debts but had also done duty—to some extent at least—as mediums of exchange. A merchant who had sold a bill of goods and taken a note as payment, could either turn the note over to a manufacturer as payment for more goods or take it

to the bank and discount it for actual cash. The latter course was frequently a great convenience, and the necessity for such accommodation continued to exist, even tho the use of the bill of exchange was fast being discontinued.

8. *Borrowing on book accounts.*—The merchant, however, was not left wholly without a means of turning his outstanding accounts into cash, for he was usually able to borrow money upon them. But this required that the owner of the book accounts be well-known to the banker; for unlike the promissory note, which gave evidence of a double transaction—involving both the maker and the indorser—the book account had only the owner's name to stand upon.

As soon as it had been demonstrated that the practice was both safe and profitable if conducted with due care, a regular system for dealing in credits of that kind gradually grew up. While at first this business was handled by the banks as part of their loan department routine, it eventually came to be the work of a special department organized for that purpose. However, many of the banks found that business of this kind, being highly specialized, was not always profitable, especially in view of the conservatism that is always necessary in the conduct of a bank. In their stead, there gradually grew up certain brokerage institutions that made a specialty of handling business paper. The brokers soon became expert in judging credits, and the brokerage concerns, as they gained in capital strength and in prestige, came to be

looked upon as valuable adjuncts to the banking system. Thus, where a bank finds itself unable to assume the risk of discounting book accounts at first hand, it is frequently able to lend money on the security which the broker furnishes.

9. *Two ways of assigning accounts.*—The exact methods by which this business is handled varies to some extent. Frequently the merchant who assigns his accounts may draw against the amount of such accounts up to a certain point—say, seventy-five per cent.

The terms upon which the merchant may assign his accounts are of course largely determined by the nature of the accounts and by the standing of the assignor himself. Often the merchant is made virtually the agent of the assignee, collecting the individual accounts as they fall due and using the money in his own business. It goes without saying, however, that in the latter case the merchant is under the necessity of replacing the collected accounts with new ones in order always to maintain a proper balance. To the merchant the advantage of this method is chiefly that it permits him to hide from his customers the assignment of their accounts.

If the bank or commission house is willing to assume all risks and buy the accounts outright, the terms are, of course, less favorable to the assignor. Usually the accounts are bought only at a heavy discount.

But while the assignment of his accounts is a perfectly legitimate procedure the merchant who finds it

necessary to resort to this expedient in order to meet his current liabilities is not always regarded in the best light by his creditors, if the matter becomes known to them. For not only does this procedure indicate that the merchant is urgently in need of funds, but the assignment of his accounts receivable, unless illegally made, withdraws these from his assets and diminishes by that amount the resources available for distribution among creditors in case of his failure in business.

10. *Registration of assigned accounts.*—One phase of this practice has repeatedly come up for discussion and has received rather severe criticism. That is the element of secrecy in the selling and pledging of accounts. It is pointed out that such a system lends itself readily to the practice of fraud, not only upon creditors but upon the finance companies that advance money on such pledges. Cases have occurred in which it was found, after the failure of the debtor, that all accounts receivable had been hypothecated. It is reported that in some cases instalment leases have been duplicated by fraudulent dealers and that bogus shipments have been recorded for the purpose of defrauding the financial house to which the accounts were sold.

This raises the question whether, in order to prevent fraud, all sales and pledges of accounts should not be made matters of public record, just as in the case of chattel mortgages. The fairness and justice of this suggestion can hardly be questioned, and it is

likely that legislation insuring such protection to legitimate creditors will be enacted.

11. *Trade acceptance*.—There is, however, a growing feeling on the part of many wholesalers and manufacturers that the present open-account system should give way to one in which the use of negotiable paper would be a more prominent feature. In support of this opinion, it is argued that if the merchant were required to accept a draft, or tender his note for the amount of his purchases, he would be less likely to fall into the common error of overbuying. He would also feel less free to annoy the wholesaler or the manufacturer with a return of goods to be credited to his account. Moreover—and this is, no doubt, the chief argument from the creditor's point of view—his bill, instead of being payable to the seller, would in that case be payable to the bank, thereby relieving the seller of the burden of carrying the account. The satisfactory operation of this plan in the chief countries of Europe, as well as in Canada, augurs well for its success if it is generally adopted in the United States, even tho in this country conditions are necessarily different in several respects.

Before the Civil War a large part of the wholesale business in the United States was financed by drafts drawn upon the purchaser by the seller. These drafts were payable in from thirty to one hundred and twenty days—sometimes even a longer period—according to the requirements of the case. They were presented to the debtor, or drawee, who “ac-

cepted" them if they were in order, and thereupon returned them to the original drawer. Such paper was termed an acceptance and usually had a high standing in the market. In the creditor's, or drawer's, hand this paper was essentially a promissory note with the drawee's credit as well as the drawer's behind it, which the latter could hold until maturity or sell if he desired. The double indorsement rendered the paper desirable at the bank as collateral.

But at the end of the war our credit system was demoralized and every merchant tried to sell his goods for cash. It was out of this situation that the custom of giving "cash discounts" arose. As an inducement to make cash payment, discounts were offered on all invoices. These cash discounts were made so attractive that it was to the buyer's interest even to borrow the cash, if necessary, in order to take advantage of the discount. In fact, the cash discount offered was generally so large that failure to take it reflected distinct discredit upon the buyer, since it was taken to indicate either very poor business judgment on his part or actual inability to borrow money at home.

This custom found general favor with the business world just after the Civil War and has been handed down to us. It possesses the advantage of relieving the seller from the burden of carrying an account. But, on the other hand, it has some distinct disadvantages. It has, for example, practically done away with the draft, and even with the promissory note, in ordinary commercial transactions. In

fact, for the seller to draw a draft or to demand a note is now often considered little less than an insult to the buyer. Few buyers pay when the goods are shipped; hence, in such a case, the seller has no acknowledgment of the debt on which he can readily borrow. Therefore if he wants a loan he is forced to employ his own credit exclusively. True, as already pointed out, he can assign his account, but this he is not always willing to do, lest it be considered a sign of financial weakness. Hence the seller is compelled to carry the debt upon his books as an account receivable, until it is paid.

12. *Three advantages of trade acceptance.*—The trade acceptance has at least three advantages. (1) It gives the seller a prompt acknowledgment of the debt. Under our system of carrying a customer's account on the books, if a firm, in order to collect a debt, has to sue upon an open account, it must go into court and swear to the justness of the claim, and must be prepared to support its contention with evidence. (2) Such trade acceptance extends the small dealer's credit field and has, moreover, a tendency to equalize credit thruout the country. Under present conditions the buyer is almost compelled to take the cash discount if he is to hold his own with competitors, and to do so he usually has to borrow in his local market. But money may be tight in his own section, altho relatively easy in other parts of the country. Rarely, however, is he able to borrow away from home. Some of the larger merchants, in

order to use their credit wherever the money rate is easiest, carry bank accounts in various centers. Some even go so far as to borrow in the easy market and lend where money is tighter. To the smaller merchant, however, this course is not usually open. (3) The trade acceptance is a readily salable asset. No safer investment for short-time funds can be found than these acceptances of commercial bills. Our business men and bankers have long felt the need for just such a liquid asset.

13. *Practical working of acceptances.*—In some quarters objection has been made to the use of trade acceptances on the ground that they appear to reflect on the debtor's credit. At first glance there seems to be some ground for this complaint; yet its advantages to both buyer and seller are capable of ready proof, and it is the experience of the houses that have adopted its use that once the practice is started with a customer, little difficulty is experienced in keeping it up. Moreover, the reform has produced an agreeable regularity in the liquidation of invoices according to terms of sale, and has thereby prevented the formerly common friction occasioned by the debtor's taking unearned cash discounts or by the creditor's charging interest on past-due accounts.

14. *An approved form of acceptance.*—In response to the request of members for a model form of trade acceptance which they might use in their business, the National Office of the Credit Men's Association got in touch with the Federal Reserve Bank of

New York, and as a result the Association, with the approval of the bank, drew up the following form:

New York, N. Y., November 16, 1915.

Seventy days after date, pay to John Doe & Co., or order, \$119.14, one hundred nineteen and 14/100 dollars. The obligation of the acceptor of this bill arises out of the purchase of goods from the drawer.

JOHN JONES AND COMPANY,  
Trenton, N. J.

JOHN DOE & Co.  
A. F. FISH, *Cashier*.

Across the face of the note the customer or acceptor writes the following:

Accepted. Trenton, N. J., November 30, 1915. Payable at Trenton Banking Company, Trenton, N. J.

(Signed) JOHN JONES AND COMPANY  
J. C. JONES.

The bank, according to the *Credit Men's Bulletin*, calls attention to the importance of the maker's stating definitely in the body of the bill, the place of payment, or, better still, the fact that the bank at which payment is to be made is in the same city or town as the home office of the drawee to whom the bill is addressed.

15. *Capital or investment credit*.—A further division of credit is that which is designated as capital or investment credit. Economists commonly distinguish between "consumption goods" and "capital goods." The value of the former consists in the fact that they satisfy some personal and immediate want, and that their usefulness generally ends with the single act of consumption, while capital goods are

valuable as a help to produce other goods. A common illustration of capital goods is the blacksmith's anvil, forge and tools.

Capital goods are not always used by their owner, however. The owner of the capital invested in a business may take no active part whatever in the conduct of that business. His interest in the enterprise may be only that of obtaining income in the form of dividends and interest payments. Railroad stocks and municipal and government bonds are good illustrations of such investments. Since investors in these forms of capital goods are generally moved by a desire to receive a regular and certain income, certainty and regularity are the chief elements in the exchanges that take place in the field of capital investment.

Deriving its name from the investment feature of the transaction, we speak in such cases of "capital" or "investment" credit. The credit instruments that result from these transactions are called "investment securities," and that form of credit is generally known by the term "long-time investment."<sup>1</sup>

16. *Relation of banking credit to commercial credit.*—Up to a certain point banking credit and commercial credit are practically identical, since it is chiefly by means of commercial credit transactions that business is created for our banking institutions. Not all banks, however, carry on a commercial banking business.

<sup>1</sup> This form of credit is the subject of the Modern Business Text on "Investment."

Those that do are called commercial banks. They are organized for the purpose of serving the business community in facilitating the exchange of commodities by means of credit instruments bought and sold by the banks.

That the presence of confidence is an essential element in credit is again seen in the relation in which such banks stand to the business community. On the one hand the depositing of funds with the banks is the community's expression of confidence in the soundness and integrity of the latter, while on the other hand, every loan granted by the banks may be viewed as an expression of the bank's confidence in the community.

The banker, having learned by experience what portion of his deposits it is necessary to keep on hand in order to meet current demands for cash, is able to use the remainder of his deposits as a basis for credit which he places at the disposal of manufacturers and merchants in exchange for their notes, bills of exchange, warehouse receipts, etc.

The foregoing discussion shows how banking credit is turned into commercial credit, and how the latter by that process becomes enlarged. For upon its deposits as a basis, the bank is able to create a large volume of credit, and by the process of discounting commercial paper to exchange its own well-known credit for the less known and therefore less generally acceptable credit of its customers.

To appreciate the significance of the last state-

ment we have but to remember that a promissory note or a warehouse receipt is not usually a convenient means of paying commercial debts. But when such credit instruments are discounted by the bank and the amount is placed to the discounter's credit in the bank, checks drawn against this credit are entirely acceptable to the business community. By such "swapping of well-known credits for less known credits," as such transactions have been called, the purposes of trade are the better served.

17. *The bank's credit latitude.*—It is of course necessary that a bank's investment in outside credit be such that the latter may readily be turned into cash whenever this becomes necessary. On that account, the majority of the investments in which a bank may engage are of a nature that yields a comparatively low rate of interest. For the purpose of being able at all times to discharge upon demand its obligations to depositors, the bank is compelled to regulate its credit operations by a consideration of the degree of convertibility possessed by the credit instruments or securities in which it deals.

Accordingly certain kinds of credit security, perfectly good in themselves but lacking the element of ready convertibility, may for that reason be excluded altogether. Before the passage of the Federal Reserve Act, national banks could not lend money on the security of real estate,<sup>1</sup> and under the regulations

<sup>1</sup> In Canada, the subject of banking is within the exclusive legislative jurisdiction of the Dominion Parliament. Under the Dominion Bank Act banks cannot lend money on real estate as the primary security,

of the Federal Reserve Board loans of this character are very strictly guarded. On the other hand, certain classes of securities may be so readily marketable that they do not come within the scrutiny of the bank's credit department. These are collateral securities given for "call loans," their present value being determined by the condition of the market rather than by the standing of the borrower who deposits them.

18. "*Business paper*" and "*loans and discounts.*"—We thus arrive at a point where we see clearly what are the characteristics of that branch of credit called banking credit. Confusion is frequently caused by the fact that certain transactions undergo a change of name by reason of the different points of view from which they are regarded. For example, such credit instruments as promissory notes and bills of exchange executed by business men are commonly designated

but may accept it as collateral or additional security. While the Act authorizes the taking of mortgages upon real or personal property by way of additional security, it is well to remember that banks cannot accept chattel mortgages in the Province of Quebec where these are not recognized by law. This restriction must not be interpreted to deny the right of a bank to take as security warehouse receipts and bills of lading and to exercise its rights over the goods covered by these documents. By a special provision also a bank may lend money to a *wholesale* purchaser or shipper of or dealer in products; to a farmer upon the security of his threshed grain grown upon the farm; or to a *wholesale* manufacturer upon the security of the goods manufactured by him or produced for manufacture. Apart from these exceptions, banks may not lend money upon the security of any goods, wares and merchandise; it may accept them as additional security or collateral.

“commercial paper” and under that name are discounted by the bank. Upon the bank’s records, however, such commercial paper appears under the name of “loans and discounts.”

In connection with “paper” of this form, certain other classifications are made by the bank. First, with regard to the security attaching to such paper, promissory notes are divided into “single-name” paper and “double-name” paper, the former designating notes that have only the maker’s indorsement, the latter representing notes that are drawn by one person to the order of another and indorsed by the latter. In the case of such double indorsement, since both indorsers are liable for the amount of the note, there is a double security for the bank.

A second classification takes into consideration the origin of the paper. In cases where such paper is the result of an actual business transaction, it is properly considered a “real” bill and rightly subject to discounting by the bank. If, on the other hand, it has no such origin it is termed “accommodation paper” and is not usually considered a sound security for a loan.

The latter classification, however, is rather an arbitrary one, since a “fictitious” bill (accommodation paper)—provided its maker is a person of known capital and standing—may rest upon what is to the bank a greater security than that which underlies what, by way of contrast, is designated a “real” bill.

## REVIEW

Distinguish between personal, mercantile, banking and capital credit.

What advantage do you find in the open-account system as compared with the earlier custom of settling by note?

Do you regard the secret pledging of accounts as a legitimate and safe procedure? If not, what objections do you raise to it?

What is a trade acceptance? How does it originate, and what advantages does it possess over the prevailing open-account system?

In what essentials do consumption goods differ from capital goods?

In what manner does a commercial bank commonly make its credit available to the merchant and manufacturer?

## CHAPTER IV

### FACTORS THAT DETERMINE CREDIT TITLE

1. *Ability and willingness to pay.*—Every credit transaction embodies two characteristic features: One is that such transaction involves the future; the other, that it constitutes an implied contract. Hence, in endeavoring to determine an applicant's title to credit favors, the credit-giver must take into consideration, first of all, the probability of the credit-taker's being able to make payment at the expiration of the credit period—whether this be thirty or sixty days or longer. He must also consider the probability of the debtor's being willing to do so. To make the transaction safe from a credit viewpoint, there must be present both ability and willingness to pay.

The first of these considerations necessarily takes account of the applicant's business capacity and financial strength; the second, of his integrity or moral character.

Obviously, there is an element of risk in every transaction that involves the future. Of every credit transaction, therefore, this is true. The credit-giver must assume this risk, tho he tries, of course, to reduce it to a minimum. In other words, he takes due

account of all the factors that bear upon the probability of the account's being paid when due.

The foregoing statement applies with equal force to a wholesale and to a retail business. In the latter, as was mentioned in an earlier chapter, it is not always easy for the credit-giver to assure himself as fully as he would like as to the credit title of his customer. Consequently, the retailer's individual risks are larger, tho the separate amounts involved are usually smaller than in the wholesale trade, where the amount of a single sale frequently runs into thousands of dollars, and where the percentage of profit on each sale is necessarily smaller than in the retail trade. In the wholesale trade it is absolutely necessary that definite credit principles be established and that certain standards be fixed by which every applicant for credit may be measured, so that the risk involved may in each case be determined with reasonable accuracy. We shall indicate briefly the lines of reasoning upon which credits are granted in the wholesale trade.

2. *Business ability, native and acquired.*—Other things being equal, the person who possesses native ability has a distinct advantage over his less fortunate competitors. The keen-witted, able-minded, aggressive man is far more likely to succeed in business than the dull, slow-thinking and easy-going one. Acquired ability, however, may be just as valuable an asset and frequently, it may be regarded with even greater favor by the credit-grantor. Business ability may be considered under the technical and financial heads.

3. *Technical ability.*—The careful manufacturer or wholesaler before extending credit to a retailer will always assure himself that the latter “knows his business.” This expression, however, may be made to mean much or little, according to the standard of the investigator. For example, it may mean merely that the credit-seeker knows quality and prices, or it may imply a broad and thoro understanding of materials, manufacturing processes, selling qualities and markets. It may also include a knowledge of storekeeping from the viewpoint of attracting and holding trade by means of well-kept store premises and neatly arranged, well-displayed goods, together with courtesy and tact on the part of the proprietor and his helpers. Lastly, it may also be made to imply his possession of that selling ability which insures the turning of his capital a sufficient number of times a year to make the business profitable. No one questions that the more ability of this sort a credit-seeker possesses, the clearer will be his title to credit favors.

In the experience of credit-givers, there is constantly brought to light an amazing amount of what is commonly called “dry rot” in the management of business concerns. Slipshod methods of conducting business, coupled with unprogressiveness in manufacturing and selling processes, are responsible for a large percentage of failures. One bank, in response to an inquiry regarding the credit title of a local manufacturer, answered: “It is an old mill, operated by old machinery, carrying an old mortgage, turning out

old-style goods sold in an old-fashioned manner." This designation would fit more than one concern, and describes the condition of "dry rot."

4. *Knowledge and experience*.—Thoro technical knowledge is not rapidly acquired. It comes only with experience. The inexperienced man who "goes into store-keeping," is handicapped from the outset and finds the chances of success decidedly against him. Such a man might be likened to a ship without a rudder. In the choppy sea of competition, such a craft, if not swamped at the very start, is almost certain, sooner or later to meet destruction upon some hidden reef or rocky shore. Not infrequently, farmers, in their desire for an easier life and larger profits, become storekeepers; but their training and experience are of little value to them in the conduct of a store, and they usually discover their mistake before long, tho not always before their small capital has been exhausted. For this reason, inquiry should always be made with regard to the length of time the credit-seeker has been engaged in his present business.

5. *Buying methods*.—Nowhere, perhaps, is technical ability more clearly demonstrated than in a merchant's buying methods. This applies with special force to the retailer, tho it is also true of the manufacturer. Among those of the former class, over-buying is an ever-present danger. The mistaken policy of many wholesale houses that emphasize quantity in the sales made to customers and that instruct their salesmen to "load 'em up," is largely responsible for

this. So also is the ambition of salesmen to "make a record" for sales and to increase their own earnings where these are computed on a percentage of sales.

Obviously, the retailer should not buy more goods than he can sell, no matter how excellent their quality or how low their price. Many business failures are the direct result of overbuying, and well-managed supply houses regard this practice as one of the most insidious evils that affect the life of a retail business.

Indeed, well-managed credit departments are constantly on guard to prevent such a condition. The credit manager of the Carnegie Steel Company, in discussing the company's credit policies, said:

We believe it poor business to allow a customer to be overloaded with steel, even tho the fault may be with his own purchasing department. While there have been times when it would have been possible for us to ship large tonnages and collect the full charge from our customers for such materials, we have so far as possible protected our customers against this dangerous practice of tying up too much capital in stock.

The ability to determine for himself just what goods will be needed for the coming season or credit period and, having determined this, resolutely to limit his purchases thereto, gives evidence of technical ability in the retail merchant.

In the case of the manufacturer, buying ability will show itself more especially in the care with which provision is made for the adequate supply of raw material in order to carry out contracts for delivery of fixed quantities of the finished product during a long

period and at fixed prices. Unless precaution is taken to insure a sufficient amount of raw material at favorable prices, the contract which was expected to yield a handsome profit may turn out to be not only a bar to such profit but a drain upon the very life-blood of the enterprise itself. The wise credit grantor will look carefully into these conditions before establishing credit relations with either retailer or manufacturer.

6. *Manufacturing*.—The ability to forecast the trend of trade and, in the case of a manufacturer, to turn one's attention to the production of goods for which a present demand is being developed augurs well for the success of the enterprise. Fortunes have been made thru a correct anticipation of a fad, a fashion, or a want created by peculiar conditions. On the other hand, over-readiness to cater to what may prove merely a local and short-lived fancy on the part of the public involves risk the extent of which is measured by the cost of the new or newly adjusted equipment which is necessary and by the value of the material and labor employed.

Such errors of judgment, however, may take place even in the production of staples. Unless the manufacturer keeps in touch with market conditions in his line of trade and with the trade situation in general he may find himself with a large quantity of manufactured goods on his hands for which there is no present demand except at sacrifice prices, thereby imperiling his profits and exposing himself to financial em-

barrassment that may render him dangerous as a credit risk.

Conservatism, alertness and business acumen must be combined to secure the best results in buying.

7. *Equipment*.—Just as undue optimism on the part of the retailer often leads him into overbuying, so a season's good business may lead the manufacturer to think that by enlarging his equipment and manufacturing facilities he may correspondingly increase his profits. Accordingly, he will sometimes reduce his quick assets in order to build an addition to his factory or instal new machinery, and as a result a fairly good business may be crippled. It may easily happen that the next season will prove as much below the average as the first one was above it, and that the temporary flurry was mistaken for the beginning of a permanently increased demand.

On the other hand, well-kept and modern machinery, suited to the needs of the plant, is indispensable to economical and profitable production. Unless the equipment can produce goods in proper quantity and quality, the manufacturer will not be able to meet the existing competition for business in his line.

It is necessary that the credit-giver be able to discriminate between legitimate, conservative enterprise on the one hand, and unreasoning optimism on the other.

8. *Advertising*.—At first sight it may appear a little fanciful to include advertising among the factors that determine a credit risk. Yet insufficient or

wrongly placed advertising may seriously limit the sale of a season's output, just as wasteful and indiscriminate advertising may add so large a burden to the cost of marketing the product as on that account to cut down profits to a dangerous point. Too much or too little advertising, its quality and the mediums selected for it—all are items of importance to the intelligent credit-giver and demand careful consideration in the determination of credit title.

9. *Location.*—The location of a retailer's store is an important factor in the success of his enterprise. The dealer is confronted with the necessity of balancing desirability of location with the cost of rents. Error may easily be made in either direction, and the vitality of the business may thereby be unduly taxed. Again, a change of location after a business has become established may, or may not, be advantageous. Conservative retail merchants generally prefer not to move, as it is rarely possible to take along more than a small part of the trade built up at the old location. In cases where the character of the old neighborhood has altered, changes of location have, at times, been the means of turning a small and unprofitable business into a large and prosperous one.

The manufacturer scarcely less than the retailer is affected by the question of location. His freight expenses depend on the distance to the market; the absence of railroad sidings means larger drayage charges both to and from the plant; even the quality

of labor obtainable is often influenced by the accessibility of the factory—all of which, since they affect the success and permanence of the business, are matters that demand thoughtful consideration from a credit viewpoint.

10. *Age*.—In determining a credit-seeker's business ability it is necessary to consider his age. A too youthful merchant frequently lacks the stability and perseverance necessary to success in business. He may have started out enthusiastically, yet after a few months' experience he may begin to doubt the wisdom of remaining in business. He may conclude that he would like to try something else or go somewhere else, rather than fight out the battle he sees before him.

Immaturity of judgment exposes the youthful merchant to certain errors less likely to occur in the case of his more seasoned and experienced competitor. Inclination to overbuying, too great optimism with regard to collections—in short, all the dangers growing out of lack of experience and business ability are present in his case.

On the other hand, youth is aggressive and ambitious. It readily adapts itself to modern methods, and is willing, as a rule, to be taught. This cannot always be said of the man of advanced age. In his case, tho we shall necessarily expect to find more mature judgment and greater fixedness of purpose, we may also find that only with difficulty does he adapt himself to newer merchandising methods. He is likely to insist upon doing things in the old way, even

tho that way be obsolete and out of tune with the spirit of the present day. In competition with merchants of more progressive ideas, such a merchant usually fares ill. Moreover, the struggle and conflict that to some extent is always present in commercial life is not usually relished by him; hence that aggressiveness which our competitive system demands in a successful merchant is likely to be lacking in the merchant of advanced age.

There are of course no fixed points beyond which on either side a credit applicant is too young or too old, but in estimating his business ability as a basis of credit the credit-giver should take into consideration the applicant's age.

11. *Evidence of financial ability.*—Usually, but not invariably, a fair measure of financial ability goes with pronounced technical ability. A dealer may have a mind that runs to analysis and to a study of details; he may understand how to attract and hold trade, yet for all that be an indifferent financier. No business can be very successful unless its management possesses good financial ability. A retailer must be able to regulate his finances so that he always has funds on hand with which to meet his merchandise bills as these fall due. To that end he must be a good collector, and must also maintain a certain definite relation between sales and outstandings.

The small dealer who possesses financial ability will resolutely refrain from attempting to do a larger volume of business than his capital warrants. Where

such ability is lacking, the book accounts will soon be disproportionately large and a corresponding portion of his working capital will be tied up in accounts that month by month depreciate in realizable value.

The dealer's financial ability manifests itself also in other ways. Old and shop-worn stocks will be sold at a sacrifice rather than be permitted to accumulate additional age and unsalableness in the store. Economy in the matter of expenditures will be practised at all times. No needless help will be kept and no extravagance permitted, either in the conduct of the business or in the proprietor's personal expenditures. Exact accounts of expenses and of the cost of doing business will be assiduously kept—the case in this respect differing greatly from that of many dealers who do not know even approximately at what cost they are doing business and who as a result supply the bankruptcy court with most of its business.

12. *Outside ventures.*—Frequently, impelled by a desire to increase their profits, dealers invest in outside ventures, when to do so involves a weakening of their condition thru withdrawal from their regular business not only of a part of their capital, but also of a considerable part of that time and attention which their business constantly demands if it is to thrive. All such temptations the merchant of good financial ability resists. He will do nothing that may imperil his credit. He fears delinquency and loss of credit standing more than he fears the loss of a possible profit. He never allows himself to be

crowded too close to the limit of his resources, but always holds in reserve some source from which funds may be obtained for use in an emergency.

13. *Distribution of due dates.*—Financial ability is seen in the proper distribution of the dates for maturing bills payable. The wise dealer will not permit his obligations to be “bunched” so that they all fall due about the same time, but will see that they are distributed over the year in such a manner as to insure his ability to meet them without embarrassment to himself or danger to his business, and so that he may employ his credit at the bank to the best advantage for that purpose.

The cultivation of confidential relations with his banker is further evidence of a merchant’s financial ability. Owing to his knowledge of markets and industrial conditions, the banker is in a position to assist the merchant in a number of ways if he is kept informed of all essential facts relating to the merchant’s business. A great deal of valuable credit information is also held by the modern banker. He is generally quite ready to pass this information on to other bankers, and receives in return credit information that is of interest to him and that may be of value to his customers.

14. *Cooperation with mercantile agencies.*—The manufacturer or merchant who keeps in close touch with the large commercial agencies, meeting their requests for information in a spirit of cooperation and mutuality, gives evidence of possessing financial abil-

ity. In common with the banker, the commercial agency man is in possession of much information that is of value to the merchant, and is often in a position to give good advice. Nothing is lost by cultivating the confidence and good-will of the agency representative. Few merchants can afford to treat the agencies with indifference, for the ramifications of the modern credit structure are such as to touch at some point everyone engaged in business. Such important credit institutions as the large commercial agencies, Dun's and Bradstreet's, should have the cooperation of every business man who in this day of rapidly changing conditions would establish and maintain his credit standing.

15. *Insurance*.—The matter of insurance will also receive due attention from men with ability in finance. The amount of fire insurance to be carried as well as the responsibility and reliability of the insurance companies selected will always be carefully considered, as well as the requirements of the insurance companies with regard to the installation of appliances and establishment of rules which reduce the cost of insurance.

Other forms of insurance, such as burglary insurance, earthquake insurance, flood and tornado insurance, when the nature of the business or the local conditions make these desirable, will not be neglected by the business man of financial ability.

16. *Payment methods*.—The outward and direct evidence of the possession of financial ability, as that

term is here used in connection with the retail merchant, is of course promptness in meeting financial obligations. That is why as a rule the applicant's "payment habits" are so carefully inquired into by the intelligent credit-giver. An untarnished credit reputation is indeed one of the greatest assets a business man can have. Once this credit title becomes clouded or impaired it is extremely difficult if not impossible to restore it to its former condition.

Injured credit has aptly been compared to "a broken piece of beautiful porcelain; you may put it together again and it may seem as good as of old, but the cracks are there and you cannot forget that it was broken."

17. *Financial strength*.—From the foregoing considerations we conclude that where both technical and financial business ability are present and sufficiently indicated, the credit-seeker has a strong claim to be considered a desirable credit risk. But even with such ability fairly marked, his credit title will be much stronger if he also possess capital sufficient to afford a guaranty of paying ability in the event that misfortune of one kind or another should overtake him. Business contingencies are so numerous and so difficult to anticipate that a certain amount of reserve in the form of realizable assets is necessary if the risk is to be acceptable to a conservative creditor. That a dealer's assets should exceed his liabilities is a necessary condition of his legitimate commercial existence.

Unless they do he is insolvent, and as such without the possession of any credit title whatever.

18. *Convertibility of assets.*—Of even greater importance than the relation of assets to liabilities is the degree of their convertibility. Some assets, such as building and fixtures, are not readily convertible into cash and are therefore termed “slow” or “fixed” assets. Salable merchandise and goods receivables whether in the form of book accounts or notes, are usually turned into money without much difficulty and are therefore called “quick” or “liquid” assets.

A comparison of quick assets with slow assets will show the amount of the dealer’s active capital, and will indicate with considerable accuracy to what credit accommodation the dealer is entitled. Even the quick assets, however, shrink considerably when an attempt is made to realize upon them by means of a forced sale. In the case of slow assets, such shrinkage is at times considerably in excess of fifty per cent. Particularly is this the case with the equipment of a manufacturing plant. Such items as tools, patents, special machinery and fixtures, while they may be worth their full valuation to the business in which they are employed, usually are of little value elsewhere, and at forced sale bring but a small portion of their original cost.

It is a matter of common observation that merchandise is convertible into cash in direct proportion to its nearness to a state of raw material. It is much

easier, for example, to turn wool or iron into money than it is to convert clothing or hardware into money. The explanation is that since manufactured goods are in a special and narrower class than the raw material from which they were made, their utility is restricted, and hence their sale is effected with greater difficulty.

19. *Liquidating values.*—In some lines of business, assets may be converted into cash with less depreciation than in others. While it is not possible in any given case to determine in advance what may be realized by forced sale on a stock of goods, the following table will serve as a guide in approximating the liquidating values in a few important lines of trade:

#### REALIZABLE VALUE.

	<i>Merchandise</i>	<i>Book Accounts</i>
Groceries .....	90 per cent.	45 per cent.
Hardware .....	80 " "	65 " "
Dry-goods .....	70 " "	67 " "
Furniture .....	68 " "	70 " "
Boots and shoes..	65 " "	80 " "

20. *Capital—how acquired.*—While at first glance it may seem a matter of little importance how a dealer's capital was acquired, yet on closer consideration it is seen that this after all has a direct bearing upon his credit title. Five thousand dollars in the hands of a man starting in business is not nearly so much of an asset if it was inherited, as if it was the result of frugality and saving on the part of the merchant himself. During the years it has taken him to save

up that sum, the merchant will have learned thru self-denial and frugal living to know the value of money, and the knowledge thus acquired is not likely to desert him when he starts in business for himself. He is almost certain to continue his practice of frugality and is accordingly not likely to spend his hard-earned dollars foolishly.

Where the capital has been acquired otherwise than by dint of personal exertion and continued saving there is not the same assurance that the funds will be judiciously handled, as is the case when the merchant has earned the money himself. The beginner in business who finds himself in possession of capital before he has learned to take care of it is in danger of losing his money thru ignorance and inexperience. "Acquiring the needful experience and education should always precede the employment of capital; but where the experience and education are undertaken to be gained concurrently with the use of capital, there is always danger that the latter will be lost before the former is gained." <sup>1</sup>

21. *Moral character in its relation to credit.*—It will be noticed that the two factors thus far considered, business ability and financial strength, have to do with the credit seeker's *ability* to make payments according to terms of sale. His *willingness* to make such payments is another matter and is equally important. Such willingness depends upon moral character. Where personal integrity is lacking, the

<sup>1</sup> Earling: "Whom to Trust."

creditor's capital, with which the debtor has been intrusted, is always in greater danger.

Here, however, we should distinguish between different degrees of culpability even tho the final outcome may be the same in every case. Thus we have the dealer who deliberately plans to defraud his creditors of their capital. He is a swindler pure and simple. Less pronounced, tho from the credit-giver's viewpoint perhaps even more dangerous, is the easy-going, self-indulgent debtor thru whose laxity and disregard of moral obligations confiding creditors are robbed of their capital. The mistake is frequently made of treating the latter class of delinquents as tho they were to be pitied rather than blamed. It is sufficient to point out that no man is blameless who diverts to his own use funds belonging to another. Even tho such a dealer has no deliberate purpose to defraud his creditors, he is nevertheless unworthy of consideration as proper credit risk. His business does not "owe him a living" unless he actually earns it. When this "living" has to come out of the creditors' capital, the boundaries of business integrity are clearly being overstepped.

22. *The customer who makes unjust claims.*—In addition to the dealer who seeks credit with a deliberate intention to defraud, and the one whose laxity of business methods causes loss to his creditors, there are those who do not hesitate in other ways to take advantage of confiding creditors. They will cancel orders and return goods for trifling or for purely imag-

inary causes. They will, without justification, set up claims for rebates and will deduct from their bills cash discounts long after the expiration of the discount period. Thru pilfering of this sort the wholesaler is deprived of profits that rightly belong to him, while his increased cost of doing business must be borne, in part at least, by those of his customers who deal fairly with him.

With decreasing profit margins, due to growing competition, the injustice of such practices is being felt more and more by wholesalers and the protests against these evils are becoming louder and stronger year by year. Many credit-givers have taken a definite stand against them. The subject is discussed more fully elsewhere in this volume.

23. *The good moral risk.*—In studying the credit-seeker's title to consideration on the ground of moral character, the wholesaler will of course inquire whether he possesses honesty, good personal habits, diligence in business, frugality and punctuality. Taken together, these determine the applicant's title to be considered a "good moral risk."

No one element stands out as paramount among the various factors of which a credit title is composed. It has been said by some whose right to be heard on such a question cannot be denied, that character is the only thing to be considered in determining a credit risk. That a good character goes a long way in business is not in question, but that it is sufficient in and by itself to secure present possession of goods or funds

on promise of future payment may well be doubted. The bank when making a loan usually looks well into the nature of the collateral no matter how high the moral standing of the borrower. The same practice obtains in every properly conducted mercantile establishment; the material assets of the credit-seeker come in for just as keen scrutiny as does his personal integrity—not infrequently they receive even greater consideration.

Moreover, whatever the financial strength and personal integrity of the credit-seeker, unless he also possess a certain amount of business ability he is not likely to be permanently successful. Hence, to say that character is the only thing to be considered in passing upon a credit risk is to ignore commonly observed facts, unless indeed the term “character” be made broad enough to include such business ability as, when coupled with integrity, almost invariably insures business success.

The existence of credit title is therefore generally determined upon the facts as they relate to these questions of character, capacity and capital.

## REVIEW

Give a concise definition of technical ability as herein applied to a merchant. Define likewise financial ability as similarly applied.

What is the ultimate test with regard to the safe ratio of assets to liabilities in the case of a merchant?

What is your view with regard to the often-heard statement that character is the sole basis of credit?

## CHAPTER V

### SOURCES OF CREDIT INFORMATION

1. *Importance of complete information.*—If the credit-giver were always in possession of all the facts that bear upon the credit-seeker's condition, he would make few errors in estimating the latter's credit title. It is because the information at hand is often incomplete and at times actually misleading that credit frequently is granted to a person, firm or corporation not rightly entitled thereto. It follows that the more complete and specific such information is, the less likelihood is there of making mistakes. The capable credit man neglects no opportunity to inform himself as fully as possible regarding the credit-seeker's actual condition, financial and otherwise, as far as this relates to his credit title.

The value of the credit information obtained must of course always be considered in connection with the sources from which it comes. Accordingly, what the credit-seeker says about himself must be viewed in a somewhat different light from that in which the report of an impartial third party is regarded. In the former case, there is always reason to believe that the information will reflect a too optimistic view of the credit-seeker's condition. It is hardly to be expected,

of course, that a merchant who seeks credit favors should of his own accord furnish information about himself that might defeat his immediate object. Under the circumstances, it will not be surprising if certain facts are withheld or certain assets given a valuation somewhat in excess of their current market value. Due allowance must be made for this tendency.

2. *Overestimating the value of references.*—For the same reason it is practically certain that a person or house given as reference has been furnished ample cause for giving the credit-seeker a “clean bill of health” as a credit risk. Obviously, such reference would not have been given unless it were known in advance that the information would be favorable. It often happens that a scheming dealer in order to obtain a large amount of goods on credit establishes himself in the confidence of one or two well-known concerns, paying his bills promptly and otherwise acting the part of a model customer. Such concerns can only bear testimony to their satisfactory business relations with this customer. If the credit man is satisfied to go no farther in his search for information, he may discover before long that he has been playing right into the hand of a clever swindler and that he has surrendered his firm’s goods to one who has no intention whatever of paying for them.

3. *Five important sources of credit information.*—There are several important sources of credit information available to the credit man of a wholesale or manu-

facturing house. These may be enumerated as follows:

1. Information furnished by the credit-seeker, usually in the form of a financial statement or, as it is sometimes called, a property statement.

2. Information furnished by mercantile agencies in the form of periodically revised rating books, weekly or monthly information sheets and special reports.

3. Corroborative information obtained from local banks, resident attorneys and similar sources.

4. Information obtained from houses selling the same trade, spoken of as exchange of ledger information or credit clearing.

5. Information obtained from representatives of the selling house. (Salesmen's reports.)

4. *The property statement: a basic consideration.*—There is one consideration in connection with the giving of credit that deserves to be constantly kept in view, namely, that the wholesaler who extends credit to a retailer becomes in a certain sense the latter's partner. He places in the retailer's hands without receiving an immediate equivalent valuable merchandise to be resold by the retailer to the ultimate consumer. The profits of both wholesaler and retailer are dependent upon such resale. Accordingly, the manufacturer or wholesaler is just as desirous of finding outlet for his goods thru the retailer as the latter is to obtain possession of them for purposes of profit thru resale.

On account of this mutuality of interest the wholesaler has an undoubted right to demand the fullest information regarding the retailer's facilities for reselling his goods at a profit and regarding his ability and willingness to render payment to the wholesaler at the expiration of the credit period. The retailer, realizing that his profits depend upon his ability to obtain such goods on credit for resale, should be equally anxious to prove to his creditor in the most conclusive manner possible that he really may be intrusted with the latter's merchandise. In other words, the interests of both retailer and wholesaler lie in giving and receiving the fullest information touching the former's title to receive goods on credit for the purpose of resale. Therefore, whatever prevents this information from being freely given, retards to some extent the transfer of merchandise from wholesaler to consumer by way of the retailer.

On this account the property statement has been made a means of conveying information which will test the existence of credit title in the retailer, a printed form being usually submitted upon which the credit-seeker enters the information asked for.

5. *Growing importance of the property statement.*—In years gone by the property statement was usually requested with an apology and either refused or rendered with bad grace. It was regarded by many dealers as an unwarranted attempt at prying into their business, and was often resented as an implication of distrust, if not as a personal insult. To-

day, modern ideas have made men understand that business confidence does not thrive in the dark and that credit, to be free and untrammelled, requires that the fullest light be admitted to the conditions which surround credit transactions.

This view of the matter has acquired increased emphasis by reason of the smaller profit margin upon which business today is being done. In most lines of business competition has driven prices down to a point where a few bad credits might wipe out the larger part of a season's profit. On that account credits are being surrounded with greater safeguards than formerly, since every precaution must be taken to insure the payment of all bills at maturity. Hence, in their demand for a property statement, wholesalers are embodying questions which probe more deeply into the retailer's status than was formerly the case.

6. *Periodical revision of signed statements.*—With regard to the frequency with which signed property statements should be demanded there is much difference of opinion. For fear of offending a customer who may be opposed to giving signed statements, some credit men ask for property statements only when circumstances of a grave or suspicious nature make such requests imperative. Others ask for signed statements only in the case of a new account, while still others request one from each of their customers new or old, at stated intervals—once a year and in some cases even oftener.

One nationally known manufacturer makes it a rule to obtain a financial statement from every new customer, either direct or thru the commercial agencies. The absence of such statement, he says, is viewed with suspicion. Another prominent manufacturer insists upon receiving a signed statement if the customer's credit title is in the least obscured. A similar attitude is taken by the Hamilton Brown Shoe Company of St. Louis, whose credit department demands a statement whenever circumstances make such a demand expedient.

Certain other prominent houses, among which is the H. J. Heinz Company of Pittsburgh, do not usually demand a statement of a new customer, nor do they, as a rule, request periodically revised statements of old customers. Such houses usually have branches thruout the country, in each of which there is a credit department. The Heinz Company has about thirty such branch houses, each with its own credit department.

In view, however, of what was said about the relation between the parties to a credit transaction, it appears that requests for initial and periodically revised statements are fully justified, unless the information sought is obtained in other ways.

Moreover, such periodical "looking the facts in the face," as the frequent revision of his property statement involves, is not a bad thing for the debtor himself. It keeps him hewing close to the line, promotes economy and efficiency, and checks the tendency

to overbuying. The value of a signed property statement is further increased by the fact that the court will hold its maker accountable for any wilful misrepresentation of the facts as stated therein. When the statement is issued for the purpose of obtaining goods on credit, such misrepresentation will be construed as an attempt to obtain goods under false pretenses, and the maker will be liable to punishment for the offense.

7. *Common forms of property statements.*—The several forms of property statements here shown are among those most generally approved. The first two are representative of the information which a bank seeks to obtain from an applicant for credit; the remaining three are forms employed by commercial houses.

It is not necessary to comment at length upon these forms or to discuss in detail the special questions they raise. A study of them will show in what particular facts the credit departments of a bank and of a mercantile house are interested, and in what special form such information is most conveniently presented. It will be noted that two types of forms are given, one for the use of an individual or partnership, and the other for a corporation.

The questions asked by the corporation statement show both in their number and character how much more intricate is the organization of capital in the corporate form than in the individual or partnership form.

For the purpose of obtaining credit for goods to be sold me or us by you, or for any extension granted me or us on my or our account with you, the following is given you as a true statement of my or our assets and liabilities and general financial condition. I or we agree to and will notify you immediately in writing of any materially unfavorable change in my or our financial condition, and in the absence of such notice, or of a new and full written statement, this may be considered as a continuing statement, and substantially correct.

**Town** ..... **County** ..... **State** .....

Value of merchandise on hand at cost.....	
Notes and accounts, cash value.....	
Cash in hand.....	
Cash in bank.....	
Fixtures, machinery, horses and wagons.....	
<b>Total Active Business Assets.....</b>	

[illegible]

Owe for mdse., open acct. of  
which \$. is past due.....  
Owe on notes for mdse.....  
Owe bank.....  
Owe others for borrowed  
money .....  
Owe taxes and rent.....  
Mtges. on fixtures, machinery,  
horses and wagons.....

[illegible]**Net Worth in Business.....**

Total real estate, assessed valuation, \$.....	
Total encumbrances.....\$.....	
Equity.....	

**Grand Total net worth in and out of Business..**

[illegible]

Please state location and description of each parcel of real estate, and cash valuation of, and encumbrances on each, and in whose name each parcel is held.....

Form A.

## SOURCES OF CREDIT INFORMATION

75

What portion of real estate described is homestead.....  
 Have you any other debts than herein mentioned?.....

Full given and surname of each partner	Age?	Married?	Possible liability of each member of firm as indorser, bondsman, etc.

What kind of business do you conduct?.....  
 Insurance on stock.....On fixtures, machinery, horses and wagons  
 .....On real estate.....  
 Amount of sales last year.....Amount of expenses last year  
 .....What proportion of your sales is on credit?.....  
 Date of last inventory.....Have you any judgments,  
 judgment notes, chattel mortgages, or other liens against you, recorded  
 or unrecorded? If so, describe.....  
 .....  
 .....

If you have pledged or transferred outstanding accounts or property  
 remaining under your control, state amount thereof and amount re-  
 ceived, or to be received, on account of such pledge or transfer.....

What books of account do you keep?.....  
 .....

Buy principally from following firms:

Name	Address	What line of business?

The above statement, both printed and written, has been carefully  
 read by the undersigned, and is a full and correct statement of my or  
 our financial condition as of.....191....

Firm signature.....

By whom signed.....a member of the firm.

All questions must be answered; insert ciphers in absence of any  
 amount. When the word "Yes," "No" or "None" will correctly answer  
 the questions, write them in their proper places.

## Form I.

Property statement sent by a bank to be filled out by an individual or partnership firm.

MESSRS. KNAUTH, NACHOD & KUHNE, BANKERS, 15 WILLIAM ST.,  
NEW YORK CITY

For the purpose of procuring and establishing credit from time to time with the above Bankers, for claims and demands against the undersigned, the undersigned furnish the following as being a true and correct statement of his or their financial statement of his or their condition on the ..... day of ..... 1911 and agree that in case any change occurs that materially reduces his or their ability to pay all claims and demands against him or them, the undersigned will notify the said Bankers without delay.

In consideration of granting any credit by said Bankers, the undersigned agree that in case of failure or insolvency on the part of the undersigned, or in the event of it appearing at any time that any of the following representations are untrue, or in case of the occurrence of such change as aforesaid or of failure to notify of such change as above agreed, all or any of the claims or demands against the undersigned held by said Bankers, shall at the option thereof, immediately become due and payable.

Further, that the exercise of or omission to exercise such option on the part of the Bankers in any instance shall not waive or affect any other or subsequent right to exercise the same.

ASSETS		LIABILITIES	
Cash on hand .....		Bills Payable for Merchandise .....	
Cash in ..... Bank .....		Bills Payable to Own Banks .....	
Bills Receivable, good, due from Customers .....		Bills Payable for Papers Sold .....	
Bills Receivable, due from Partners .....		Open Accounts .....	
Accounts Receivable, good, due from Customers .....		Deposits of Money with us .....	
Accounts Receivable, due from Partners .....		Mortgages or Liens on Real Estate .....	
Merchandise (at actual present cash value) .....		All Other Notes .....	
Real Estate belonging to Firm .....		Other Indebtedness and of what composed	
Machinery and Fixtures .....			
Other Assets and of what composed			
Total .....		Total Liabilities .....	
		NET WORTH .....	
Total .....		Total .....	

Contingent Liability { Accommodation Endorsement .....

{ Endorsed Bills Receivable Outstanding .....

Names in full of all General Partners { .....

Names in full of Special Partners with amounts contributed by each, and until when, { .....

Date of organization and expiration of Partnership .....

State last date of taking trial balance and if same proved .....

Memorandum .....

Please sign here

By ..... Date signed ..... 1911

# SOURCES OF CREDIT INFORMATION

77

## Form II.

Property statement sent by bank to be filled out by a corporation.

MESSRS. KNAUTH, NACHOD & KUHNE, BANKERS, 15 WILLIAM ST.,  
NEW YORK CITY

For the purpose of procuring and establishing credit from time to time with the above Bankers, for claims and demands against the undersigned, the undersigned furnish the following as being a true and correct statement of his or their financial statement of his or their condition on the..... day of ..... 191 and agree that in case any change occurs that materially reduces his or their ability to pay all claims and demands against him or them, the undersigned will notify the said Bankers without delay.

In consideration of granting any credit by said Bankers, the undersigned agree that in case of failure or insolvency on the part of the undersigned, or in the event of it appearing at any time that any of the following representations are untrue, or in case of the occurrence of such change as aforesaid or of failure to notify of such change as above agreed, all or any of the claims or demands against the undersigned held by said Bankers, shall at the option thereof, immediately become due and payable.

Further, that the exercise of or omission to exercise such option on the part of the Bankers in any instance shall not waive or affect any other or subsequent right to exercise the same.

ASSETS		LIABILITIES	
Cash in ..... Bank .....		Bills Payable for Merchandise .....	
Cash on hand .....		Bills Payable to Own Banks .....	
Bills Receivable, Good .....		Bills Payable for Papers Sold .....	
Accounts Receivable, Good .....		Open Accounts .....	
Bills or Accounts Receivable, due from officers .....		Bonded Debt (When due .....) .....	
Merchandise, finished (How Valued) .....		Interest on Bonded Debt .....	
Merchandise, unfinished (How Valued) .....		Mortgages or Liens on Real Estate .....	
Raw Material (How Valued) .....		Chattel Mortgages .....	
Real Estate .....		Deposits of Money with us .....	
Machinery and Fixtures .....		All Other Notes .....	
Other Assets and of what composed {	.....	Other Indebtedness and of what composed {	.....
	.....		.....
	.....		.....
	.....		.....
	.....		.....
Total .....		Total Liabilities .....	
		Capital .....	
		Surplus, including undivided profits .....	
Total .....		Total .....	

Contingent Liability { Accommodation Endorsement .....

{ Endorsed Bills Receivable Outstanding .....

Specify any of above assets or liabilities pledged as, or secured by, collateral, and state collateral.

.....

## CAPITAL

Authorized.....Subscribed.....Paid in.....  
 Held by Company as Treasury Stock.....  
 How paid in: Cash \$.....Other property \$.....  
 Description of other property and how valued.....  
 What portion of real estate, if any, has been acquired through bad debts.....  
 In whose name is title to real estate held.....  
 Incorporated in what State and under what General Law or Special Act.....  
 Date of charter.....Commercial business.....  
 Are Stockholders liable beyond amount of stock subscribed.....  
 If so, to what extent.....  
 Amount of annual business.....Annual expenses.....Annual dividends.....  
 When was last dividend declared.....Rate.....  
 Insurance carried on merchandise.....Real Estate.....  
 Is Mortgage above state a first lien on all the assets.....  
 Regular times of taking inventory.....  
 Give basis of statement, whether actual inventory, by whom { .....  
     taken and, date, or if estimate, by whom made and date { .....  
 What amount, if any, of acc'ts and bills rec. not charged off, is past due, extended  
     or renewed.....  
 Amount charged off for bad debts last year.....  
 Amount recovered during same period.....  
 Amount charged off account of plant preceding year.....  
 State last date of taking trial balance and if same proved.....  
 Regular times of balancing books.....  
 Number of bank accounts, and where kept.....

## OFFICERS.

NAME IN FULL	ADDRESS
President .....	.....
Vice-President .....	.....
Secretary .....	.....
Treasurer .....	.....

## DIRECTORS.

NAME IN FULL	ADDRESS
.....	.....
.....	.....
.....	.....
.....	.....

Please Sign Company's Name here.....

By .....

Date Signed.....191....

## PROPERTY STATEMENT BLANK

RECOMMENDED AND INDORSED BY THE  
NATIONAL ASSOCIATION OF CREDIT MEN

*THE RECIPROCAL VALUE OF A SIGNED STATEMENT*

Good credit in the markets of the world enables every merchant to add to his ability to do business. It gives him the use of enlarged capital, thus enabling him to carry a more complete stock, increase his sales, and magnify his profits.

*Large assets are not always necessary to the creation of credit; what is most desirable is, that credit be in relative proportion to the actual assets, and in harmony with conditions which create and maintain it. A merchant's capital is the sum of his net available resources, plus his credit.* The giver of credit is a contributor of capital, and becomes, in a certain sense, a partner of the debtor, and, as such, has a perfect right to complete information of the debtor's condition at all times.

Credit is given a merchant because of the confidence reposed in him. Requesting a statement when credit is asked is not a reflection on one's character, honesty, or business ability, but is done to secure information to enable business to be conducted intelligently.

*When a statement is made it should be absolutely correct.* To make it so necessitates the taking of at least an annual inventory and the keeping of an accurate set of books. Statement giving, therefore, will tend to make a debtor a better buyer, because more familiar with his stock, more careful in giving credit, more conservative in incurring debt, and will result in a better knowledge of his business generally.

*A merchant who desires to serve his own best interests should recognize that his most valuable possession, apart from his actual assets, is a sound, substantial and unquestioned reputation as a credit risk, and that, under the prevailing conditions and demands of business, the most effective, and eminently the best way to prove his basis for credit, is to be willing to submit a statement of his financial condition.*

NOTE: The above estimate of the value of a statement to both giver and receiver is the embodiment of the thoughts and experiences of scores of the leading credit men of the United States who are members of the National Association of Credit Men and who thus desire publicity given to their views in order that there may be the largest benefits to both retailer and wholesaler.

Standard Form A.

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Form IV.

PROPERTY STATEMENT BLANK<sup>1</sup>

RECOMMENDED AND ENDORSED BY THE NATIONAL ASSOCIATION OF CREDIT MEN

"Large assets are not always necessary to the creation of credit; what is most desirable is, that credit be in relative proportion to the actual assets. The giver of credit is a contributor of capital and becomes, in a certain sense, a partner of the debtor and, as such, has a perfect right to complete information of the debtor's condition at all times."

To RICH, MANN &amp; CO., New York:

Dated . . . . . 191

For the purpose of obtaining credit for goods to be sold me or us by you, or for any extension granted me or us on my or our account with you, the following is given you as a true statement of my or our assets and liabilities and general financial condition. I or we agree to and will notify you immediately in writing of any materially unfavorable change in my or our financial condition, and in the absence of such notice, or of a new and full written statement, this may be considered as a continuing statement and substantially correct.

BUSINESS ASSETS		Dols.	Cts.	BUSINESS LIABILITIES		Dols.	Cts.
Cash value of Merchandise on hand				Owe for Merchandise, not due			
Store Furniture and Fixtures				Owe for Merchandise, past due			
Cash in hand				Owe Notes for Merchandise			
Cash in bank				Owe Banks			
Accounts good and collectible				Owe Relatives and Friends			
Notes good and collectible				Owe Taxes			
Store, Building				Owe Rent			
and Lots, \$ . . . . . } Equity				Total Business Liabilities			
Mortgaged, \$ . . . . . }				Net Worth in Business			
Other personal property				Total			
Total Business Assets				If any of above liabilities are secured, state particulars in proper place below.			

OUTSIDE ASSETS		Dols.	Cts.	Full Given and Sur- name of Each Partner	Age	Married	Liability as Endorser or Bondsman
Total Real Estate owned							
Less exempt portions							
Total Real Estate not exempt							
Encumbrance on Real Estate not exempt							
Net Equity in Real Estate not exempt							
Other Property not exempt							
Total Outside Property							
Debts not enumerated above							
Net Outside Assets							
Net Worth in Business							
Total Net Worth in and out of Business							

Included in Liabilities in Above Statement:		Merchandise consists of	
Mortgage on Merchandise . . . . . \$ . . . . .	Suits Pending . . . . . \$ . . . . .	Dry Goods . . . . . \$ . . . . .	
Mortgage on Furniture and Fixtures . . . . . \$ . . . . .	Judgments . . . . . \$ . . . . .	Notions . . . . . \$ . . . . .	
Mortgage on Horses and Wagons . . . . . \$ . . . . .	Judgment Notes . . . . . \$ . . . . .	Clothing . . . . . \$ . . . . .	
Mortgages on Other Personal Property . . . . . \$ . . . . .	Mechanics' Liens . . . . . \$ . . . . .	Boots and Shoes . . . . . \$ . . . . .	
What proportion of Sales is on Credit . . . . . \$ . . . . .	Amount of Sales Last year . . . . . \$ . . . . .	Hats and Caps . . . . . \$ . . . . .	
REMARKS—Give details and explanations of questions not fully answered above			
If you have pledged or transferred outstanding accounts or property remaining under your control, state amount thereof and amount received, or to be received, on account of such pledge or transfer . . . . . \$ . . . . .		Groceries . . . . . \$ . . . . .	
		Crockery . . . . . \$ . . . . .	
		Hardware . . . . . \$ . . . . .	
		Total . . . . . \$ . . . . .	
The above statement, both printed and written, has been carefully read by the undersigned, and is a full and correct statement of my or our financial condition as of . . . . . 191			
Town . . . . . State . . . . .		Firm Signature . . . . . a member of the firm	
On the reverse side of this sheet is given a complete list of houses I or we deal with, and amount owing each one; also a description of all real estate owned.			
Standard Form D.			
1 Sent by a commercial house to be filled out by an individual or partnership firm.			

Form V.

# PROPERTY STATEMENT BLANK <sup>1</sup>

**RECOMMENDED AND ENDORSED BY THE NATIONAL ASSOCIATION OF CREDIT MEN**

"Large assets are not always necessary to the creation of credit; what is most desirable is, that credit be in relative proportion to the actual assets. The giver of credit is a contributor of capital, and becomes, in a certain sense, a partner of the debtor, and, as such, has a perfect right to complete information of the debtor's condition at all times."

To RICH. MANN & CO., New York:

For the purpose of obtaining credit now and hereafter for goods purchased, we herewith submit to you the following statement of our resources and liabilities, and will immediately notify you of any material change in our financial condition.

In consideration of your granting credit to the undersigned, we agree that in case of our failure or insolvency, or in case we shall make any assignment for the benefit of creditors, bill of sale, mortgage, or other transfer of our property, or shall have our stock or plant attached, receiver appointed, or should any judgment be entered against us, then all and every of the claims which you have against us shall at your option become immediately due and payable, even though the term of credit has not expired. All goods hereafter purchased from you shall be taken to be purchased subject to the foregoing conditions as a part of the terms of sale.

ACTIVE BUSINESS ASSETS	Dollars	Cts.
Cash value of merchandise on hand		
If manufacturing, raw material,		
\$---finished, \$---unfinished,		
\$-----		
Notes and accounts, cash value		
Cash in hand		
Cash in bank		
Bills or accounts receivable, due		
from officers		
Patents and patterns		
Fixtures and machinery		
Total real estate, cash value, \$---		
Total encumbrances on real estate		
\$-----		
Equity		
Total Active Business Assets		

BUSINESS LIABILITIES	Dollars	Cts.
Owe for merchandise open acct.,		
of which \$-----		
is past due		
Owe for notes for merchandise		
Owe banks		
Owe for bills for paper sold		
Owe others for borrowed money		
Owe taxes and rent		
Mortgages on fixtures and machinery		
Total Business Liabilities		
Net worth in Business		

## OFFICERS

Name in Full	Address
President	
Vice-Prest.	
Secretary	
Treasurer	

## DIRECTORS


Contingent Liability
Accommodation
Indorsements ..
Indorsed Bills
Receivable and
Outstanding ....
Authorized Capital ....
Subscribed...Paid in...
How paid in: Cash, \$..
Other property .....
Incorporated in what
State and under what
General Laws or Special Act?.....
Nature of business?....
Date of charter?.....
Suits pending, and of what nature? .....
Are any merchandise creditors secured in any way?.....
Amount of annual business .....
Annual expenses.....
Annual dividends....
When was last dividend declared .....
Rate..... Insurance
carried on merchandise
.....On fixtures and
machinery .....
On real estate .....
Regular time of taking inventory .....
Keep bank account with .....
Keep the following books of account .....
If you have pledged or transferred outstanding accounts or property remaining under your control, state amount thereof, and amount received, or to be received, on account of such pledge or transfer .....

## REMARKS:

The above statement, both printed and written, has been carefully read by the undersigned, and is a full and correct statement of our financial condition as of 191 .....

Dated ....., 191 ....., State ....., Town ....., Corporation Signature ....., By .....

On the reverse side of this sheet is given a list of houses we deal with  
 1 Sent by commercial house to be filled out by a corporation. Standard Form G.

The types given as examples for commercial houses were selected from a series of forms recommended by the National Association of Credit Men. The items appearing upon these forms are substantially alike, tho their arrangement differs somewhat. Note particularly the paragraphs describing the reciprocal value of a signed statement. They show that the Association of Credit Men seeks to educate the commercial world to recognize and conform to the standards demanded by a sound credit policy.

8. *What the property statement should tell.*—Among the things which a property statement should make clear, or which the credit man otherwise must endeavor to learn, are the following:

1. Is the capital sufficient, and has it been contributed in cash? If not, in what does it consist?

2. Of whom is the firm composed, and do the partners understand the business?

3. Is the stock listed at a fair valuation, and has proper allowance been made for depreciation?

4. Has a fair allowance been made for doubtful credit, and have all bad debts been written off or otherwise provided for?

5. Do liabilities appear to be disproportionately large? To whom and for what have liabilities been assumed?

6. Is the buying reasonable in amount?

A further consideration of the financial statement will be found in another chapter.

9. *A recent statement form.*—It is interesting to

note the efforts that are made by credit-givers to provide a statement form that shall afford no loophole for evasion or for wilful misrepresentation. A recent form devised by the Liberty National Bank of New York is a good illustration of the tendency in this direction. The bank provides three forms, each adapted to one of the three forms of business, i. e., individual, partnership and corporation. In substance, however, these forms are alike.

The individual form is reproduced on the following pages.

10. *The salesman as a credit reporter.*—Among the earliest sources of credit information about a retail merchant was the report furnished by the salesman who visited him in his store and sold him a bill of goods. At first glance it may seem natural to combine in one person the offices of salesman and credit man. In practice this is usually undesirable. Between the two functions there is often a wide gulf. The self-interest of the salesman frequently places a distance between the firm and the customer which the resources of the credit department are unable to span.

Some one has said that of the four chief factors which enter a salesman's considerations, he himself comes first, the credit man fourth, and between these two the customer and the house. While it may be doing injustice to the salesman to accept this statement as invariably true, it is nevertheless a matter of observation that in a large number of instances the

Name .....  
 Business ..... Location .....  
 Branches .....

### TO THE LIBERTY NATIONAL BANK OF NEW YORK.

For the purpose of procuring credit from you from time to time, direct or otherwise, I herewith submit the following true and accurate statement of my resources and liabilities as shown by my books on.....

In consideration of the granting of such credit I agree that should I make a bill of sale, a mortgage or other transfer of a considerable portion of my property without due notice to you, or should my stock be attached, or should I make an assignment for the benefit of my creditors, or should a petition in bankruptcy be filed by or against me, then all and every claim you have against me shall become at your option immediately due and payable.

ASSETS				LIABILITIES			
Cash .....	.....	.....	.....	Creditors:			
Customers:				On Open Ac-			
On Open Ac-				counts			
counts .....	.....	.....	.....	Notes Payable			
On Notes Re-				for Mdse.			
ceivable .....	.....	.....	.....	Notes Payable			
Controlled or Al-				to Banks .....	.....	.....	.....
lied Concerns:				Notes Payable			
Notes, Accounts				to Others .....	.....	.....	.....
Receivable, etc..	.....	.....	.....	Other Current			
Merchandise:				Debts:			
Manufactured .....	.....	.....	.....	(Itemize): ..	.....	.....	.....
Unmanufactured ..	.....	.....	.....				
Plant and Ma-							
chinery .....	.....	.....	.....				
Furniture and							
Fixtures .....	.....	.....	.....				
Real Estate (Full							
Value — Mort-							
gage entered							
in Liabilities)	.....	.....	.....	Mortgage Debt—			
Other Assets				when due .....	.....	.....	.....
(Itemize): .....	.....	.....	.....	Net Worth .....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
Total	.....	.....	.....	Total	.....	.....	.....

Between the date of the above inventory and the present time I have had no serious losses thru bad debts or otherwise (except) .....  
 and my condition today is fully as good as set forth by the above figures.

Sales for Year ...	.....	.....	.....	Amount Withdrawn			
Gross Profit ...	.....	.....	.....	During year .....	.....	.....	.....
Net Profit .....	.....	.....	.....	Depreciation			
Other Income				charged off .....	.....	.....	.....
(Specify): ..	.....	.....	.....	Amount carried to			
.....	.....	.....	.....	Reserve .....	.....	.....	.....
.....	.....	.....	.....	Amount added to			
				Net Worth .....	.....	.....	.....
				.....	.....	.....	.....

**CONTINGENT LIABILITY:** { I have no contingent liability of any kind or nature as indorser or guarantor (except as follows) .....

My merchandise is insured for \$..... Plant, bldg., and machinery, \$.....

None of the accounts or notes receivable included in the statement made above has been assigned, pledged or discounted (except as follows) .....

Neither have any of my other assets been pledged or assigned as collateral for any of my liabilities (except as follows) .....

I have no interest in any other concern (except:—Name affiliations and location) .....

There are no suits pending against me (except) .....

The form of obligation used in the financing of my business is my plain note (indorsed by) .....

No one has any interest in this business besides myself (except—State amount contributed, and when subject to withdrawal) .....

I have no personal worth outside of this business (except) .....

My books are not audited by a Certified Public Accountant.....

The date of last Audit was.....made by.....

BANK ACCOUNTS	LINES GRANTED	Under Discount on Statement Date
.....	.....	.....
.....	.....	.....
.....	.....	.....
.....	.....	.....
.....	.....	.....
.....	.....	.....

(Please sign name here).....

Date Signed .....1.....

salesman's judgment is not to be fully trusted on questions relating to the customers' credit title. It is equally true, however, that the credit man may obtain thru the salesman information of a certain kind not easily obtained from other sources and that such information is a valuable supplement to the reports received thru the commercial agencies and other channels.

The information that may rightly be demanded of the salesman he can easily supply from his own ob-

servation and experience. So long as the salesman is not required to ask questions which would embarrass both him and the customer, it is perfectly proper to make use of his services in the compilation of credit data. The following form has been used in this connection, the salesman filling out and attaching it to his order sheet.

Firm name .....	Address .....	
Date .....	Salesman .....	
<i>In General</i>		
Business good?	Growing?	Competition?
<i>In Particular</i>		
Store neat?	Well located?	Any advertising signs?
Stock kept in good order?	Well displayed?	Well stocked or low?
Clerks well trained or incompetent?		Kept busy?
Proprietor a good business man?		Social standing?
Drink?	Gamble?	Other firms bought from?
.....		
.....		

Whenever conditions seem to warrant it, the credit man may ask for a revised report on the same form, thus keeping his information up to date.

Despite the denial of some credit men, there is no doubt that an observing salesman is in a position to furnish credit information of distinct value. He has the very important advantage of observing the customer in his business surroundings and is thereby enabled to draw first-hand conclusions, a privilege that

is denied the distant credit man. It is more than probable that many credit men fail to avail themselves as fully as they might of the assistance which the sales department is able in this way to render—a lack of sympathetic understanding often blocking the way.

For the existence of such a condition the credit man is as a rule chiefly to blame. It is a mistake to demand of the salesman that he go prying into the affairs of the customer as tho he were a mercantile agency reporter or a detective in quest of damaging evidence. The salesman's mission is primarily to sell goods. Any additional function which may conflict with sales is obviously distasteful to him and will not ordinarily be well performed.

There is nothing objectionable, however, in requesting the salesman to keep his eyes and ears open while in the customer's store and to gather all the information he can about the character and volume of the merchant's trade, his sales methods or his store premises. The salesman will often be able, by a casual question or two directed to the hotel clerk, the livery man or a salesman for another house, to learn a good deal about the merchant's social standing in the community. All information of that sort should be jotted down and forwarded to the credit man without delay.

A salesman's report differing in some respects from the one shown on a former page is reproduced here. This form is employed by a large shoe house in the

Southwest and shows what information that house especially desires to obtain thru its salesmen.

## NEW ACCOUNT

FILL OUT AND ATTACH TO ORIGINAL ORDER

### CREDIT DEPARTMENT

Date.....  
 Name .....  
 Address .....  
 Carries stock of about \$.....Insured for \$.....  
 Over- or under-stocked? .....Location good?.....  
 Attentive to business? .....Is business prosperous?.....  
 Local opinion of habits and ability .....  
 Local crop or business conditions: .....  
 .....  
 .....

OBTAIN FINANCIAL STATEMENT IF POSSIBLE; BUT ALWAYS FURNISH  
 SEVERAL REFERENCES ON EVERY NEW ACCOUNT

#### References:

NAME

ADDRESS

- 1.
- 2.
- 3.

Remarks: .....  
 .....  
 Salesman .....

11. *The traveling credit man.*—The practice of employing traveling credit representatives arose from the necessity on the part of large houses to obtain direct information about certain classes of accounts which because of their number and magnitude frequently become not only heavy but doubtful risks. This method of gathering credit information is necessarily expensive, but the extent and complexity of modern wholesale business seem to demand it more and more since

it is not usually possible for the credit manager to visit far-away customers except in cases of unusual importance.

The function of the traveling credit man may be said to be the complement of that of the traveling salesman. The responsibilities of the position of a traveling credit man call for a man of experience—one who can analyze critically the customer's books, examine his stocks, and if necessary make use of the information obtained from banks, local attorneys and commercial agencies. The visit of such a man is the best substitute for that of the credit manager himself for he brings to the investigation a knowledge of both sides of the situation since he is well acquainted with the details of the local business as well as with the policies of the credit department of his house. He is able to view any disputed point from the standpoint of both the customer and his house and can suggest mutually satisfactory settlement. His chief business is tactfully to learn the actual conditions of the dealer. Despite his best efforts, the traveling credit man finds that he is often regarded with mixed feelings by those on whom he calls, as his visits are likely to carry the suggestion that a doubt exists at headquarters with regard to the dealers' financial soundness.

For all that a traveling credit man of the right caliber is frequently able to give excellent advice to the small dealer and to instruct him in principles of good merchandising. He often finds a dealer who is unsystematic and ignorant of many things that he

ought to know relating to ordinary principles of successful merchandising. In fact some of these dealers are not capable of managing their business unaided in such a way as to be safe credit risks. The traveling credit representative by tactfully instructing and strengthening the ignorant or weak merchant not only increases the latter's chances of success, but makes him a better and a safer customer.

The traveling credit representative is often able to serve his house still further by promoting harmony and cooperation between the departments of sales and credits, eliminating by his visits the causes of friction that sometimes arise between these two.

As evidence of the character and extent of credit information obtained by such traveling representatives, the report form shown on this and the following page is of interest. To obtain the desired information calls for considerably close questioning of the subjects of the report; but in the hands of a capable and tactful representative of the credit department the examination need not be either long or painful.

.....BRANCH 191....

**NOTE:** Traveler must attach Merchant's Bill Head, Letter Head or Card.

No.....

Name of Firm ..... Town ..... State .....

Address ..... (Street Address required in towns of 5000 or more population)

Full Name of Name ..... Age ..... Married? .....

Partners or owners. Name ..... Age ..... Married? .....

If a corporation, Name ..... Age ..... Married? .....

position held, Name ..... Age ..... Married? .....

(Pres., Sec'y., etc.)

Kind of business ..... Successor to ..... How long in business at this location? .....

Give former address if ever in business before .....

What kind of business? ..... How long in that business? .....

From ..... to .....

Why did he discontinue? .....

If failed, what settlement was made with creditors? .....

If never before in business, what has been his occupation, and by whom employed?

Does he give business his personal attention?.....Is his business growing?.....  
 Is he active?.....Is he attentive to business?.....Is he experienced?.....  
 What are local opinions as to his habits?.....  
 What do you consider are his chances for success?.....  
 What credit limit do you advise?.....  
 Value of real estate \$.....Insured for \$.....  
 Mortgage on real estate \$.....Net value of real estate \$.....  
 In whose name is title to real estate held?.....  
 Value of stock \$.....Insured for \$.....  
 Value of fixtures \$.....Insured for \$.....  
 Chattel mortgage \$.....No. of clerks?.....No. of wagons?.....  
 Monthly sales \$.....Monthly expenses (Including Rent) \$.....  
 Sell for cash or on credit?.....Appearance of stock and store?.....  
 Character of neighborhood, viz., poor, medium, or high-class?.....  
 Competition keen?.....How many chain-stores in vicinity?.....  
 Banks with .....

Give References and your Personal Opinion on other side of this sheet.

12. *Local attorney as credit reporter.*—In every city and town of any consequence there are to be found attorneys who specialize in commercial business or who at least have departments for the handling of such business. These attorneys assist in collecting claims against local debtors from out-of-town creditors. They undertake to bring suit in court when circumstances demand such a course, and give attention to claims in bankruptcies, etc., as described more fully in another chapter.

Such attorneys are usually in a position to render valuable service to the distant credit man. Their profession brings them in close contact with the business and the business men of their localities. Their training qualifies them for judging accurately local business conditions. Moreover, their relation to the community enables them to use their information without thereby violating any trade confidence and without injury to their own business interests.

In cities large enough to offer a considerable amount of commercial business, law firms have found

this class of business distinctly profitable and have gone to considerable expense and trouble in collecting and filing information relating to the credit standing of local merchants. Frequently the credit man obtains very valuable information from such sources.

13. *Law lists and free attorney reports.*—A number of law lists or attorney directories are published in which attorneys seeking commercial business have their names and addresses entered. For “representation” of the list in their town or city the attorneys pay the publishers a certain yearly fee, the amount of this fee depending upon the size and business importance of their respective localities.

These law lists are placed in the hands of wholesale houses, collection agencies, and others who may have out-of-town claims to collect. The publishers generally guarantee the prompt remittance of all moneys collected by the attorneys listed in their publications. For the purpose of securing a large use of their lists by those who have profitable business to send to attorneys, publishers generally demand of the latter that they furnish upon request free credit reports on merchants in their localities. Report blanks are provided for use of the subscribers and sold to them at a certain price per hundred, the understanding being that in return for such free reports the attorney is to receive whatever collection business the forwarder may have in the attorney’s locality.

This plan is by no means infallible; it is usually

satisfactory in direct proportion to the energy and interest displayed by both attorney and forwarder. The free-report system has been greatly abused. Merchants have often been found to send under cover of two or three law lists inquiries to several attorneys in the same town, promising in return to each attorney whatever collection business they might subsequently have in that locality. At times two or more attorneys in a town on comparing notes, would discover that they were being "worked" by some ambitious credit man who sought to obtain the largest possible amount of free information about a local dealer. These abuses eventually became so flagrant that many attorneys refused to continue the free-report service. In many counties bar associations adopted a schedule of fixed rates for all legal services performed by their members, these rates also covering the furnishing of credit reports. Owing to the growing antagonism with which commercial attorneys generally view what they term the "free report evil," the use of these reports is less extensive than formerly.

It is not to be denied that an attorney report, if carefully prepared, contains information not easily obtained from any other source. As a sample of the character and amount of information sought by means of a free report a form commonly used for that purpose is shown in these pages. As may be judged from the nature of the questions, the preparation of the report requires the expenditure of considerable time and

labor. It is easily understood that the attorney who receives in his morning's mail from six to twelve such inquiries is not likely to look upon the free-report system with special favor. Accordingly, in most instances only such questions are answered as may be answered offhand. Frequently indeed the inquiry goes into the wastebasket unanswered.

#### SAMPLE FORM OF "FREE" REPORT

Dear Sir:

Will you please report in confidence as to character responsibility, etc.,  
of .....

Yours very truly,

.....  
M'd's'e .....  
Realty .....  
Cash .....  
Other means .....  
Incumbrance on realty .....  
Other indebtedness .....  
Character .....  
Habits .....  
Business ability .....  
Do you regard safe for .....on.....time?  
If not paid can you collect? .....  
Ever fail? .....  
Remarks .....  
.....  
.....

For the purpose of comparison, another form of attorney report is presented, with which the sender incloses one dollar as compensation for the attorney's services. It is easy enough to say upon which of these reports the attorney looks with greater favor; it is equally easy to determine in advance which of them will be of greater value when returned to the inquirer.

## SAMPLE FORM OF "PAID" REPORT

PREPARED AT THE INSTANCE OF THE NATIONAL ASSOCIATION OF CREDIT MEN

Dear Sir:

Your name appears on our list as having represented us, or as being ready to look after our interests should occasion arise requiring your services.

Inclosed, therefore, please find \$1.00, for which kindly send us confidentially as complete a report as possible on this blank on .....  
 ....., especially answering the various questions specified. Delayed reports are of no use, therefore be prompt, please. Do not disclose our name as inquiring. File our name as being interested in above business and advise us at once of any change affecting his or their financial standing.

Yours truly,

Name ..... Town.....  
 County ..... State.....  
 Full names of ..... Nationality?.....Age?.....Married?.....  
 All partners ..... Nationality?.....Age?.....Married?.....  
 ..... Nationality?.....Age?.....Married?.....  
 How long in present business?..... What amount of capital invested? ..... Ever failed?..... When?.....  
 How did they settle? ..... Ever been sued?..... Ever asked extension? ..... Any evidence of overdue indebtedness?.....  
 If so, of what kind and amount? ..... Reputation, good, fair or bad for ability? ..... Honesty?..... Promptness?.....  
 Is he doing a good business? ..... Location relative to business center? ..... Is stock in good condition? ..... Your estimate of amount of stock carried? \$..... Is it insured? .....  
 Value of real estate above ..... Of whom does he buy goods if exemptions and incum- you know? .....  
 brances .....\$.....  
 Value of other assets ....\$.....  
 Your estimate total net .....  
 worth above all debts, ex- .....  
 emptions and incum- .....  
 brances .....\$.....

## REMARKS

Any answers which cannot be made in above spaces kindly indicate by some mark and amplify here .....  
 .....  
 .....

Opinions differ among the larger houses of the country regarding the value of attorney reports. Some firms make extensive use of such reports, others use them only occasionally.

14. *Banks as sources of credit information.*—Supplementing the local attorney as a source of credit information, the local bank renders a similar service of value to the business world. Such institutions in the course of their daily business acquire a wealth of reliable information touching the financial condition, the business and social standing of local merchants and of other business men in their town.

The bank's attitude towards the commercial world differs somewhat from that of the commercial attorney, inasmuch as the bank may have an interest in the affairs of a local merchant just as great as that of the distant wholesaler who is applying for information. If the merchant inquired about is a borrower at the bank, the bank is necessarily anxious that nothing should take place that might endanger the borrower's ability to repay his loan.

It should always be remembered that banks are not usually so well acquainted with a local dealer's condition as is the latter's jobber, since the former institutions, owing to the greater caution generally exercised by them, usually demand security for their loans, while the jobber or merchandise creditor exacts no security. Accordingly, the jobbers or wholesalers are compelled to exercise closer supervision over the account, hence their experience with a debtor is likely

to be of greater value as affording more dependable credit information than the opinion of the bank which holds the debtor's security for its loan.

For this reason among others, many large houses rarely make use of banks as sources of credit information. Others do so only under certain circumstances, as when the customer himself gives the bank as reference. Still others are inclined, even under these conditions, to discount the value of the bank's report, unless, as expressed by one credit manager, "the information is secured for us by our own bank." The last statement carries its own suggestion, tho we do not maintain that the statement is in every sense fair to the banks.

Banks have been accused of undue delay in answering inquiries for credit information, and this delay has been advanced as an objection to the use of banks in this capacity. We are inclined to think that this charge could not be uniformly sustained, since banking institutions as a rule are models of efficiency.

## REVIEW

What may be said in favor of the financial statement as a basis for credit, and to what causes may misleading information contained therein generally be attributed?

In what respect does the work of a traveling credit representative differ from that of a traveling salesman with regard to the investigation of credit conditions?

What is the nature of the credit information you would expect to obtain from a commercial attorney?

What circumstances may be supposed to influence the bank in answering requests for credit information on a local merchant?

## CHAPTER VI

### MERCANTILE AGENCIES

1. *Mercantile agency service.*—The two large credit institutions known as Dun's and Bradstreet's Mercantile Agencies are the outgrowth of the conditions that govern credit-giving in this country. Few realize the size and scope of the machinery that is operated by these agencies in their work of gathering credit information. The entire country is served by their branch offices, while in every city, town and village, their representatives are found busily investigating local tradesmen and new enterprises. The services of these agencies have been extended abroad until now their connections reach virtually to every part of the business world.

The present mercantile agency system dates from about 1837 and was an immediate result of the panic which occurred in that year. The extensive speculation which at that time prevailed in the West was painfully felt in New York which was then, as now, the financial center of the United States. The commercial agency came into existence as a means for determining with reasonable accuracy the credit responsibility of the merchants of the country.

In the year 1841, under the name of Lewis Tappan

and Company, the first mercantile agency was established in New York. In the beginning it did but a small business. At that time it possessed only indifferent facilities for collecting comprehensive and reliable credit information, hence the reports which it issued generally lacked the necessary completeness. As its facilities improved, however, the agency grew in popularity as well as in influence. It had gained a recognized position as an important institution when, in 1860, Mr. R. G. Dun became identified with it and gave it his name, which it still bears.

In 1849, a second mercantile agency made its appearance. That was the firm of J. M. Bradstreet and Company. These two agencies, Dun's and Bradstreet's, have continued to the present time and are now so large and so well-established that it is more than doubtful that a rival institution could be established. The attempt has repeatedly been made—sometimes backed with large capital—but invariably without success.

2. *How mercantile agency information is collected.*  
—The organization by means of which the mercantile agencies collect their information is one that touches every person engaged in business in the United States and Canada. In all the important cities in the country district offices are located. These offices constitute central points at which the information sought by the agency is conveniently collected.

In large cities this work is specialized by assigning to certain reporters certain lines of trade. Since each

important line has its own special reporter the agency is in a position to keep well informed of current happenings, and is accordingly able to disseminate among its subscribers prompt and reliable information about the various lines of trade within the cities covered.

Territory outside the larger cities is divided into districts, to each of which a reporter is assigned. In such districts the local reporter investigates all the lines of trade found therein. As these reporters cover the same territories year after year, they become well-acquainted with local trade conditions and have many opportunities to study the business of each individual concern. Like the newspaper reporter, the commercial agency reporter has a nose for news—that is, for such news as is of interest to creditor houses. Any rumor affecting the credit of a local dealer is promptly investigated and the result is reported to the nearest district office.

Each of the large and independently operated offices has sub-offices in the smaller cities. The number of such sub-offices is governed by the size of the territory and the volume of business ordinarily transacted, some district offices having as many as eight or more sub-offices.

In territories where reporters make only periodical visits, the agencies depend upon local commercial attorneys, postmasters, or reliable merchants for information regarding sudden changes or developments that may occur in the standing of local merchants.

3. *Contents of the agencies' reports.*—The informa-

tion collected by the agency reporter and by him transmitted to the district offices, is of three kinds:

1. Strictly news items.

2. "Impressions," which deal with tendencies or rumors. If, for example, a certain dealer is believed to have become lax in his payment habits, or to be dividing his attention between his business and outside ventures, or if his personal habits are said to have become irregular, the matter is reported as being important from the agencies' point of view.

3. Special reports prepared upon the request of a subscriber, or for the purpose of completing the agencies' files.

If a district office desires a special report on a dealer who lives outside its immediate territory, the nearest sub-office in the dealer's locality is notified, and the reporter is set to work gathering the information upon which the report is to be based. Copies of such reports are usually distributed among district offices in anticipation of requests for them on the part of subscribers.

4. *Dun's and Bradstreet's rating books.*—Next let us ask: By what means does the mercantile agency distribute to its customers or subscribers the credit information which it gathers? One way in which this information is made accessible to merchants and manufacturers is thru periodically issued rating books. These books, which are revised quarterly, contain the name and address of practically every person engaged in business in the United States and Canada. Two

ratings are given—a capital rating and a credit rating. The capital rating is intended to show how much capital is invested in the business, tho it is generally understood to mean “the commercial value or the par value of the assets which the firm rated may be considered to have in its business, all things regarding the terms and the business being taken into consideration.” The credit rating expresses the agency’s opinion with regard to the degree of confidence to which the firm is entitled. In order to determine the latter the character and ability of the dealer or firm are considered in connection with the amount of capital invested in the business.

## KEY TO R. G DUN’S RATINGS

	<i>Estimated Pecuniary Strength</i>	<i>High</i>	<i>General Credit</i>		
			<i>Good</i>	<i>Fair</i>	<i>Limited</i>
Aa	Over \$1,000,000	A1	1	1½	2
A+	\$750,000 to \$1,000,000	A1	1	1½	2
A	500,000 to 750,000	A1	1	1½	2
B+	\$300,000 to \$500,000	1	1½	2	2½
B	200,000 to 300,000	1	1½	2	2½
C+	125,000 to 200,000	1	1½	2	2½
C	75,000 to 125,000	1½	2	2½	3
D+	50,000 to 75,000	1½	2	2½	3
D	35,000 to 50,000	1½	2	2½	3
E	20,000 to 35,000	2	2½	3	3½
F	10,000 to 20,000	2½	3	3½	4
G	5,000 to 10,000	..	3	3½	4
H	3,000 to 5,000	..	3	3½	4
J	2,000 to 3,000	..	3	3½	4
K	1,000 to 2,000	..	3	3½	4
L	Less than 1,000	..	..	3½	4
M	Less than 500	..	..	3½	4

KEY TO BRADSTREET'S RATINGS

			<i>Estimated Wealth Grades of Credit</i>				
			<i>1st</i>	<i>2d</i>	<i>3d</i>		
G	.....	\$1,000,000 and above					
H	.....	500,000 to \$1,000,000	.....Aa	A	B		
J	.....	400,000 to 500,000	.....A	B	C		
K	.....	300,000 to 400,000					
L	.....	250,000 to 300,000					
M	.....	200,000 to 250,000					
N	.....	150,000 to 200,000					
O	.....	100,000 to 150,000	.....B	C	D		
P	.....	75,000 to 100,000					
Q	.....	50,000 to 75,000					
R	.....	35,000 to 50,000					
S	.....	20,000 to 35,000					
T	.....	10,000 to 20,000	.....C	D	E		
U	.....	5,000 to 10,000	.....D				
V	.....	3,000 to 5,000					
W	.....	2,000 to 3,000					
X	.....	1,000 to 2,000					
Y	.....	500 to 1,000	E				
Z	.....	.... to 500				.....E	

It is not to be expected, of course, that these ratings should in every case be in perfect accord with actual conditions. It must be remembered that the agency has no means of compelling the dealer to give out information about himself or about his business. If he is unwilling to furnish such information, the agency is compelled to gather it from other sources as best it may. Moreover, inasmuch as about three thousand changes occur daily in the credit ratings of the country, it is readily seen that the rating book must contain a large number of errors even on the very day of its pub-

lication. For all that, however, the ratings given by the large commercial agencies are on the whole remarkably exact.

5. *Special credit reports.*—The mercantile agencies usually seek to obtain from every dealer a property statement or its equivalent as a basis for the information to be kept in their files, adding to the information thus obtained such other data as its local reporters may from time to time obtain. From this information special reports are prepared for subscribers at their request. These reports include a record of the dealer's business and personal character, his wealth, in and out of business, his debts, his associations and his reputation. They contain, also, a description of the business itself—capital, debts, outstanding accounts, the volume of annual business, and frequently the names of the chief creditors. In a concluding statement, the agency offers its judgment with regard to the worth, credit limit and other factors bearing upon the credit risk involved.

As a general rule, the information on file in the agency's office is revised only twice a year. But since many things may happen within six months to change materially the dealer's financial condition, the cautious credit man will usually seek corroborative evidence regarding the customer's credit title before acting upon the information contained in the agency report. Mention has already been made of such corroborative evidence in the form of bank and attorney

reports. In another chapter we shall consider still another form of such evidence.

6. *Trade reviews and market conditions.*—In another way the large mercantile agency serves the business community—namely, by means of a weekly review of trade conditions and of current market quotations. Business men regard this weekly review as one of the most authoritative opinions obtainable, on trade and on financial and industrial conditions generally. As an aid in gauging the current credit condition of the country correctly this feature of mercantile agency service is of no small value.

7. *Cost of the agency service.*—The cost of the mercantile agency service (Dun's or Bradstreet's) varies somewhat according to the subscriber's territory, but is approximately \$150 for two half-yearly rating books and one hundred special reports. Quarterly rating books, instead of half-yearly, may be had at a correspondingly extra charge. Additional special reports are furnished by the agencies at an average rate of fifty cents each.

8. *Special trade agencies.*—In addition to these two large general agencies, there are now a number of special agencies operating within a single trade or within a few allied trades. It is claimed for these special agencies that they are better able to serve the needs of the trades to which they cater than are the larger agencies, which attempt to cover all lines of trade. This advantage is denied by the advocates of

the general agencies, who maintain that the latter, by reason of their wider contact with business and with trade conditions in general, obtain information that is inaccessible to the smaller organizations. Whether or not this claim is justified, the continued existence and apparent growth of the trade-agency idea justifies the belief that this form of service possesses definite merit.

Like the general agencies, these special agencies usually publish quarterly or half-yearly rating books, issue monthly or weekly information sheets embodying all recent trade information, and furnish special credit reports upon request. As a rule, the special trade agencies employ a finer division of capital and credit ratings than do the general agencies, frequently including a third or "pay" rating, the object of which is to avoid, if possible, mere generalizations with regard to the person or firm under investigation.

9. *Special credit agency in the metal trade.*—Among the various special trade agencies may be mentioned that of the metal trade, which bears the name of the Iron and Steel Board of Trade. This agency, with headquarters in New York, enumerates the following special lines as among those that it serves directly: Manufacturers and distributors of iron, steel, brass and copper; hardware, stoves, furnaces, steam and hot-water heaters; plumbers' and steam-fitters' supplies; engines and boilers, explosives and contracting supplies; foundry, factory, mill and electrical machinery and supplies; automobiles

and accessories; carriages, wagons, agricultural implements, and all other metal products.

The Iron and Steel Board of Trade issues semi-annually its "Blue Book" of credit ratings, in which are listed, according to the agency's claim: "all buyers of metal goods or goods into which metal enters in any way." The Blue Book is a volume of some 1,200 pages and contains more than 200,000 names.

In addition to its rating book this agency issues a four-page weekly supplement sheet, by means of which all changes in credit ratings are noted, so that by entering these changes in the rating book, subscribers may keep the latter corrected until its next revision.

It is claimed for the special reports issued by the Iron and Steel Board of Trade that they "include an epitome of the ledger experience of a number of those who sell the subjects of inquiry, as well as signed statements, local records as to character, habits and ability, and also bank references and comments."

This agency will send inquiry forms to subscribers who are believed to possess information with regard to a dealer whose credit standing is under investigation. The form shown on page 108 is used for this purpose. It is mailed to, say, twenty-five subscribers; the resulting information is tabulated, and a report is prepared and issued, one copy being sent to each of the twenty-five subscribers who contributed the information upon which the report is based.

Still another feature is what is called "The Watch Service," whereby the agency offers for a nominal fee to "watch" a subscriber's customers and give immediate warning whenever any of them appears to be weakening financially. This service requires that the subscriber file with the agency a complete list of his customers.

A collection department is also operated by the Iron and Steel Board of Trade for the benefit of its subscribers. This department is conducted upon the usual collection agency basis of contingent fees.

### IRON AND STEEL BOARD OF TRADE

CLEARING HOUSE FOR CREDITS AND ADJUSTMENTS

NEW YORK, N. Y., .....191

GENTLEMEN:—

Will you please answer by *return mail*, as fully as possible, the following questions regarding:

.....

In return for this information we will send you, *upon request*, without charge, a copy of our report when completed, giving you the Ledger "experience" of others in the trade selling this party.

IRON AND STEEL BOARD OF TRADE,

WOOLWORTH BUILDING, New York City.

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Sold how long? .....Date of last sale?.....  
 Highest amount of credit given? .....Average monthly purchase?.....  
 On what terms? .....  
 Amount now owing you? .....Amount past due?.....  
 Are payments made in full or on account? .....  
 Are settlements made by notes? .....  
 What limit do you place on the account? .....  
 Discount, prompt, fair or slow pay? .....  
 Ever placed account with attorney?.....When?....Disputed or not?....  
 Amount of unfilled orders now on hand? .....

Do they buy for cash and take time? .....  
 How do you regard them personally?.....  
 How do you regard the risk? .....  
 Remarks: .....  
 .....  
 .....  
 .....

**AB** Above request is made in order that SELLERS everywhere, in all markets, may interchange their Ledger experience with each other, for their mutual protection in credits. The information you give this Board will be treated in confidence. The names of parties giving their "experiences" are never mentioned in connection with the report.

10. *Special agency in the jewelry trade.*—The National Jewelers' Board of Trade is the title of an agency that caters to the need of manufacturers and sellers in the jewelry lines. This agency, with headquarters in New York City, has branch offices in Providence, Chicago, Cincinnati and San Francisco. The branch offices are operated under the direction of local members of the board of directors, and are in a position to deal promptly with local questions as these arise, without having first to consult headquarters.

As in other lines of business the agency issues twice a year a reference book, a confidential weekly sheet and special reports.

"Observation Reports" is the title given to reports furnished by the members' traveling salesmen. Upon a special form which they carry with them, the salesmen enter such information touching the dealer's credit as they are able to gather during their periodical visits to his store.

The agency also issues "emergency reports," for the purpose of giving early warning of impending

business embarrassments. These reports are sent only to such members as are known to be interested in the subject of the report.

One unique feature of the service of this agency is the maintenance of a prosecution fund, used for the investigation and prosecution of fraud within the jewelry trade. This fund has been repeatedly used in bringing about the conviction and punishment of fraudulent debtors. The false stamping of jewelry is another evil for the suppression of which the agency's prosecution fund has been successfully employed.

The agency has special committees for dealing with the problems that are peculiar to the various branches of the trade, such branches being designated as the gold, gold-plate, silverware, platinum, diamonds and gems, optical, watch and clock branches.

11. *Special agency in the furniture trade.*—At least two agencies cater to the credit information wants of the furniture trade. One of these is the Furniture Commercial Agency Company, which has offices in seven of the important furniture centers of the country. This agency publishes a "Red Book" of credit ratings, and does for its subscribers substantially what other trade agencies do for theirs.

The main ratings are three in number, viz., credit, capital, and pay ratings. In addition, a list of numerals is employed, each of which denotes a certain condition or fact relating to the credit standing of the

subject. A key furnishes the interpretation in each case. Some of the conditions indicated by the use of numerals are the following:

Discounts bills.	Pays at convenience, no regard for terms.
Prompt at maturity.	Deducts discount in violation of terms.
Satisfactory pay.	Kicker, or very arbitrary and exacting.
Fairly satisfactory; occasionally slow.	Will not answer letters.
Slow pay.	Forces extra time when giving notes.
Exceedingly slow pay.	Claim placed for collection.
C. O. D. or cash transactions recommended.	Would now refuse to sell.
Usually settles with note and pays at maturity.	Caution recommended.
Complains of goods without cause.	Seems to be ordering too freely, appears suspicious.
Troublesome to do business with.	Will not accept drafts.

A weekly *Reporter*, containing records of fires, failures, dissolutions, new dealers, bankruptcy information, collection items, etc., within the furniture trade, is sent to subscribers, as is also a weekly "tracer" for the collection and exchange of trade information.

As evidence of the thoroness with which such trade agencies collect and disseminate credit information, the report on the following pages is interesting. It is of the kind commonly prepared by the Furniture Commercial Agency Company.

In addition to its reporting service the Furniture Commercial Agency Company also operates a collection department.

## CREDIT REPORT FURNISHED BY THE FURNITURE COMMERCIAL AGENCY COMPANY

Sub: (3)

Thomas, S. R.

F. U. C. &amp; S. 45

Redfield, Pa.

Age 46 Md.

423 &amp; 425 West St.

Nov. 29, 1915.

**ANTECEDENTS:**

He started in this business March 10, 1900, opening a new store. Was formerly employed as chief clerk at the Redfield office of Wm. Brown & Co., Inc., coal operators. Never failed or had a fire.

**RESOURCES:****Previous statements:**

Date	Assets	Liabs.	Net worth
Nov. 25, 1901 .....	\$14,947.44	\$2,711.54	\$12,235.90
June 6, 1904 .....	24,094.52	5,959.88	18,134.64
Dec. 23, 1907 .....	24,947.34	4,900.00	20,047.34
Sept. 23, 1913 .....	26,186.95	6,550.00	19,636.95

Statement made Nov. 20, 1915, based on inventory of March 31, 1915, as follows:

**ASSETS:**

Mdse. on hand .....	\$ 8,400.00	
Book accts. and notes considered good.....	19,828.71	
Cash on hand and in bank .....	347.52	
Real estate. Residence belongs to wife and is not included.		
Undertaking equipment and stock, horses, wagons, etc. ....	10,000.00	\$38,576.23

**LIABILITIES:**

Owe mdse. open acct. not due and past due.....	4,900.00	
Owe mdse. closed by note not due and past due.....	3,550.00	
Borrowed money, principally own collateral .....	800.00	8,550.00

Net worth ..... **\$30,026.23**

Amt. annual sales \$30,000. Ins. on stock and equipment, \$9,000.

(Signed) S. R. THOMAS,

By S. R. Thomas.

It was reported when he started business that he had \$4000 cash capital, of which \$900 was his own, \$2,000 borrowed from his mother-in-law, and \$1,100 borrowed from a local bank.

Comparison of his statements indicates that he has made gradual financial progress. His business is done largely on the instalment plan, and it will be noted that his statement indicates that his merchandise indebtedness amounts to fully the value of his stock, leaving only the book accounts and undertaking equipment upon which to base financial rating. Book accounts would no doubt shrink very materially in other hands, and considerable allowance should be made for losses, expenses of collection, etc. An estimate of about \$15,000 as covering net worth is believed to be about correct.

#### SUMMARY:

He has built up a fairly good business from a small beginning, but always has been very slow pay and claims for collection have been received very frequently. Conditions in this respect seem to have been very much the same with him for some years, but many houses continue selling the account, understanding that it is a slow one and being willing to take the risk, in the belief that he always will eventually pay.

#### COLLECTION AND COMPLAINT DEPT. RECORD:

Eight collection items handled by the Agency during 1908;—four during 1909;—three during 1910;—fourteen during 1911;—eleven during 1912;—twelve during 1913;—and twelve during 1914.

*12. Mercantile agency in the shoe and leather trade.*  
—Still another prominent trade agency is the Shoe and Leather Mercantile Agency with headquarters in Boston. Its quarterly issued rating book covers manufacturers and dealers in leather and shoes and in kindred lines of trade. In addition to its large quarterly rating book, this agency publishes a smaller book of rating, limited to manufacturers of boots and shoes. This book is issued for the special benefit of the agency's leather trade subscribers.

Special credit reports, a daily bulletin of failures, changes, etc., a tracer system for procuring ledger information and a collection department are prominent features of the service rendered by this agency.

The subscribers for this service include a majority

of the tanners, manufacturers and wholesalers in boots and shoes thruout the country.

**13. *The Consolidated Building Trades Credit Association.***—One limited credit agency that appears to perform an important service in a difficult field, and to perform it well, is the Consolidated Building Trades Credit Association of New York. This association's activities are limited to the building interests within the boroughs of Manhattan and the Bronx, New York City. The membership of the association is made up of material men, contractors, builders and bonding companies.

The following description of the association's activities, which was supplied by its secretary-treasurer, Mr. H. G. T. Nerge, furnishes excellent proof of the economic value of cooperation in the protection of the credit interests of an important trade:

**Purpose:** To aid its members in guarding against extending credit accommodation to parties financially or morally unworthy of credit; to adjust disputes, claims, etc., by arbitration; to make charges of failure to pay or unfair methods a part of the association's credit reports after arbitration or trial by special committee; to consolidate the interests of material men and contractors on a "broken down" building operation and secure completion of such operation that it may be sold and at least a part of the old indebtedness salvaged; to act as the center thru which business experiences may be exchanged and the source of information withheld from the parties receiving reports; to rate builders, general contractors, etc.; to use the association's influence in all matters that will be beneficial to the building industry and to credit grantors in said industry.

Each Tuesday afternoon a committee of thirty, made up

of credit men representing the building-loan interests, material men and contractors, meets at the association office. All credit information received by the association is read to this committee, which passes upon each return and establishes or revises credit ratings on the strength of previous items on file, new items and the committee men's own knowledge of the person or firm in question. As the character of credit in the building industry differs largely from general commercial credit, four items affecting credit standing are passed upon, to wit, financial strength, moral strength, which is affected by methods of doing business, association, habits or previous failures, ability and the operation on which credit is asked, and other operations in which the party is interested, amount of building loan, mortgages, investment, cost of construction, location, etc. These credit headings are marked A-1, good, fair, poor or hazardous.

Weekly sheets are sent to members which advise them of new operations, transfers, mortgages, liens or similar instruments possibly affecting creditors in the building industry.

## REVIEW

What were the conditions in the United States out of which arose the demand for the commercial agency?

What are the chief features of the modern commercial agency service?

What is the difference between capital rating and credit rating?

If the dealer's mercantile-agency rating is given as "F-3 Dun," what condition on his part does this indicate?

What are the arguments in favor of the special trade agencies, and what is urged against them in support of the general agency?

## CHAPTER VII

### COOPERATIVE METHODS IN CREDIT INVESTIGATION

1. *Credit cooperative methods.*—Within recent years, many wholesalers came to feel that despite the excellence of the service usually rendered by the large mercantile agencies with their extensive organizations and with the ramifications of their investigating system there was a certain element lacking, namely a convenient way for creditors selling in the same market to exchange ledger experience. While the two large agencies endeavor to furnish a certain amount of trade experience, it was felt that their present plan of operation does not permit them in this respect wholly to meet the need of the business world.

Accordingly, efforts have been made within trade lines to distribute information obtained from the ledger experience of the members of such trades, and various bureaus have been established for the purpose of facilitating such exchanges.

The purpose of an interchange system, as set forth by an officer of a leading agency, is to provide "an impartial medium between debtors and creditors and between creditors themselves, and to establish a sys-

tem whereby those who are interested in any accounts may freely and unreservedly interchange the facts contained in their ledgers, without the necessity of direct reference, each to the other; without divulging this information under their own name; and at all times receiving in exchange for items contributed by them the combined experiences of all the others interested in the account."

2. *Characteristics of ledger experience.*—As will be seen, this form of credit information differs materially from that supplied by the ordinary credit agency, for the interchange of ledger experience does not concern itself directly with antecedents, or with the dealer's character and reputation. It does not even take into consideration the size of his capital. Such an interchange system takes account solely of the subject's recent purchases and payments. Thru information submitted by other members, an inquiring member may usually learn whether his customer has placed orders with other houses, how much he is owing on account, and whether he is meeting his payment obligations with due promptness.

In the judgment of experienced credit men, this form of information constitutes the most valuable basis of credit extension at present available to the manufacturer and the wholesale merchant. It is now pretty well recognized that the record of a dealer's purchases and payments, provided it is sufficiently complete, affords more material for intelligent credit analysis than the combined testimony of agency ratings and

reporters' opinions. Obviously, the value of such a system depends chiefly upon the extent to which the selling houses participate. At first, considerable difficulty was experienced in inducing merchants to participate in an exchange of ledger information. They were loath to give out information about their customers for fear this information might be used in some way to the detriment of themselves or their customers. Of late, a more enlightened view of the matter is being taken, and as a result this method of investigating credit risks is rapidly gaining favor.

## RETAIN THIS FOR YOUR FILES

JAMESTOWN, N. Y.,.....191

M.....

We give you below OUR EXPERIENCE with

Name .....

P. O. ....

PLEASE CONSIDER INFORMATION STRICTLY CONFIDENTIAL

Yours truly,

WHITE, GRAY &amp; Co.,

FURNITURE MANUFACTURERS

		MANNER OF PAYMENT
Sold Since .....		
Terms .....		Discounts
Highest Recent Credit \$.....		Prompt and satisfactory
Owing Now { On Open Account, \$....	.....	Slow but considered good
{ On Notes, \$ .....	.....	Slow and unsatisfactory
Past Due.. { On Open Account, \$....	.....	Pays C. O. D.
{ On Notes, \$ .....	.....	Sell for cash only
First Order, \$ .....	.....	Account secured
Other Information .....	.....	Notes secured
.....	.....	Account closed for cause
.....	.....	Makes unjust claims
.....	.....	Collected by attorney

## RETURN THIS TO US

JAMESTOWN, N. Y.,.....191

M.....

Kindly give us below YOUR EXPERIENCE with

Name .....

P. O. ....

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,

WHITE, GRAY &amp; Co.,

FURNITURE MANUFACTURERS

		MANNER OF PAYMENT
Sold Since .....		
Terms .....		Discounts
Highest Recent Credit \$.....		Prompt and satisfactory
Owing Now { On Open Account, \$....		Slow but considered good
{ On Notes, \$.....		Slow and unsatisfactory
Past Due.. { On Open Account, \$....		Pays C. O. D.
{ On Notes, \$.....		Sell for cash only
First Order, \$.....		Account secured
Other Information .....		Notes secured
.....		Account closed for cause
.....		Makes unjust claims
.....		Collected by attorney

*3. Procedure in the exchange of ledger information.*—One form of such credit interchange is that which is carried on between dealers without the intermediary of a central bureau. The form shown on this and the preceding page has the approval and recommendation of the National Association of Credit Men and is one that is frequently used for this purpose.

The two blanks, as will be noted, are identical save for the lines at the top. The first is filled out by the inquiring member, who thereby shows his

willingness to give information as well as to receive it. This inquiry, together with the second blank form, is thereupon sent to the house of which inquiry is to be made. The latter promptly enters upon the second blank and in the spaces provided therefor, the information of which it is in possession and returns this form to the inquirer.

4. *Reciprocity a necessary element.*—Obviously such a system demands of each participant absolute fairness and constant readiness to furnish such information as may legitimately be asked. Without the whole-hearted cooperation of all, the best results are not attainable.

In order to avoid abuses of this nature, the Credit Men's Association, under whose auspices the report form above illustrated was prepared, has drawn up a series of rules to govern exchange of credit information among its members.

An example of reciprocal exchange of credit information is furnished by the manufacturing hat-makers who sell to the jobbing trade. Their entire product is put on the market thru about a dozen commission houses. These commission men cooperate in handling the trade. An actuary is hired by them, and to him all orders and payments are submitted.

5. *Operating thru a central bureau.*—While a satisfactory system of credit interchange may be conducted without the aid of a central bureau, particularly when it is operated on a small scale, it is usually found more convenient to maintain such a

bureau, since this permits the information sought by members to be obtained more quickly and thereby to be made more readily available to them.

The following describes a way in which this work is commonly carried on:

Let us assume that fifty wholesale houses agree to participate in exchange of credit experience, and that a central bureau is established and provided with a clerk or secretary in charge. The first step consists of giving to each member a number, and of preparing and distributing among such members a list of firms with their respective numbers. The next step is to file with the bureau a complete list of active customers, including all who have bought goods within a certain period—say, two years. A card is made out for each of these customers and is filed alphabetically. Upon each of these cards are entered the numbers of those houses that are shown to be selling the dealer whose name the card bears. Accordingly, as the clerk picks up a dealer's card he can tell at a glance what members are interested in that particular customer. He knows, therefore, where information about that dealer may be had, and he also knows what members among the fifty will be interested in learning of any change, favorable or unfavorable, that may occur in that dealer's condition.

Suppose an order comes to one of the fifty from a dealer with whom he has had no previous business. He promptly sends this dealer's name to the central bureau, and the clerk, upon examining the cards on

file, discovers on this dealer's card the numbers of, say, three of the members. He thereupon enters the three numbers upon the inquiry form, and returns it to the inquirer, thereby informing the latter where information about his new customer may be obtained. The desired information may then be obtained by means of three letters or three telephone calls. The inquiring member may learn in this way that the dealer's credit is being shut off by his former supply houses on account of delinquency or unfair treatment, and may find in this fact an explanation of the receipt of the unsolicited order that prompted his inquiry. His treatment of the order henceforward will, of course, be governed by the information he has obtained thru the bureau. He may decide to request a financial statement before consenting to fill the order, or if the information justifies such a course, he may even demand cash in advance. If on the other hand the inquirer should learn that the dealer is paying his bills promptly, that he buys his goods carefully, and that in other respects he acts the part of a model customer, he would of course be disposed to fill the order on the usual credit terms, even if he should deem it advisable to carry his investigation a little further before actually shipping the goods.

Such a method can be used to advantage only when all the participating members live in the same city or within easy communicating distance of one another.

6. *Credit clearing*.—Under another plan, also operated locally, tho gradually extending its field of operation, both inquiries and the information are received at a central office, and from there distributed among the members. Suppose that the morning's mail brings to the central office ten inquiries concerning dealers who buy in the local market. The names of the parties inquired about are entered upon a report sheet, and this sheet is distributed by messenger among the members. Thereupon each member to whom the sheet is sent enters opposite the name of each dealer a statement of his experience with that dealer. In other words, if the dealer is or has been his customer, the member enters upon the sheet the amount now owing, what part of this amount is past due, and such other information relating to the customer's payment habits, etc., as is called for, or as may seem advisable to communicate.

When these comments are received at the central office, a report is prepared embodying the sum of the information obtained. Each member receives a copy of this report. No names of informants appear upon these reports, such names being known only to the central office. For the sake of convenience, letters of the alphabet and abbreviations of words are employed in conveying this credit information.

7. *Inherent defects of credit clearing*.—Nearly ideal as this plan appears to be, there are nevertheless features which to a considerable extent limit its usefulness. For example, it will be seen after a mo-

ment's reflection that a system of credit interchange in order to be of sufficient practical value must be participated in by the larger portion of possible creditors. To illustrate: If the number of possible creditors selling a certain line of goods in a certain market is one hundred, and if of this number only ten, twenty or thirty participate in the interchange system, it follows that the volume of information obtainable under such circumstances is insufficient to cover fully the credit dealings of a buyer in that market. As is readily seen, the farther below one hundred the total membership is, the less complete will the returns in this case be and the less valuable will be the interchange as a source of credit information. Conversely, the nearer to one hundred the number of participants is the more complete will the information be and the greater also will be the value of the information obtained.

It must also be remembered that the larger the membership the more numerous will be the inquiries; hence the more arduous the work of furnishing the information asked for. It is easily conceivable that if the membership in such an association continues to grow, a point will sooner or later be reached at which the work demanded of each member in connection with the answering of inquiries and the expenditure of time and labor incident thereto—perhaps the entire time and service of a clerk—will be found to be out of proportion to the benefits derived. When that point is reached, the system plainly becomes impracticable.

In that case, the membership is automatically reduced to a point where the system is once more workable. This automatic limitation seems to indicate that the ordinary system of "clearing" ledger information will hardly attain universal application. When it is restricted to one or to merely a few markets, however, there is no ground for questioning the value and practicability of the system, always provided that the members live up to their agreement and treat one another fairly.

8. *The Credit Clearing House.*—The Credit Clearing House is, without doubt, the chief exponent in this country of the system of obtaining credit information by means of ledger experiences. Established about 1890, this agency today covers about 500,000 retail merchants in its investigations.

Each member of the Credit Clearing House is required to register with that agency the names of his customers and to contribute information whenever any of his customers are under investigation. In each case the member receives a copy of the report summarizing the information contributed by the other interested members in addition to that contributed by himself.

The ledger facts sought by this agency are gathered from every important market. Merchants are given an opportunity to submit their financial statements in order that the contents of such statements may be added to the other information contained in the report that is sent to inquirers. The report in

its entirety is made up of the facts thus contributed and possesses the merit of being free from the bias of personal opinion.

9. *The percentage system.*—Investigation has shown that one of the chief items in such a report relates to the subject's manner of paying his bills. An index to his manner of payment is arrived at by the use of percentages. Thus, if out of twenty-five reporting houses, ten say that payments are slow, this fact appears in the report as follows:

“25 payment experiences, 40 per cent slow.”

If earlier reports were cleared, their percentages are also given in order that it may be shown whether the merchant is doing better or worse. To illustrate: A certain New York merchant failed in 1915. In the agency's records the percentages in his case read as follows:

February, 1913, 18 payment experiences, 22 per cent slow.  
January, 1914, 20 payment experiences, 35 per cent slow.  
January, 1915, 15 payment experiences, 53 per cent slow.  
March, 1915, 19 payment experiences, 79 per cent slow.

Another important item covered by the Credit Clearing House report is the attempt to buy an unusually large amount of merchandise. Such an attempt is also recorded in the form of percentages. In the case of a house that failed, the amount of new credit sought was 63 per cent. It has been found that if a dealer is slow with more than 70 per cent of his creditors, failure is likely to overtake him at any moment. A climbing percentage of new credits

asked by the merchant also draws attention to a weakening condition.

Experience based upon the observation of a large number of failures shows that the failure level is reached when slowness of payments approximates 80 per cent. If new credit is also involved, the failure level is reached when the combined percentages of slowness and new credit reach 120 per cent.

Where new credit is the sole disturbing factor, reports of new credit asked from more than 60 per cent of the houses inquired of call for careful scrutiny of the situation. Where this percentage is distinctly favorable, little fear need be felt as to the safety of the account; but when it is not so distinctly favorable, the detailed report should invariably be examined.

Except in the smaller markets, it is rarely necessary that all a dealer's creditors be included in such reports. Information from a representative body of creditors generally serves every purpose.

When the demands for new credit are found to be unusually numerous, the Credit Clearing House calls special attention to this fact by suggesting to its members that a report should be consulted before further credit is allowed. At the same time, the dealer himself is asked by the agency to explain his increased demands, and this explanation, if at all pertinent, is sent to all interested members.

10. *Giving credit advice.*—The Credit Clearing House offers to interpret its reports for the benefit

of subscribers and on the basis of such reports to render credit decisions on cases submitted to it. This service is, perhaps, of more special value to manufacturers whose business is not large enough to warrant the employment of a professional credit man.

The membership of the Credit Clearing House is said to embrace more than thirty lines of trade and to cover the chief manufacturing sections of the country.

11. *A probable credit interchange system of the future.*—It seems to be fully within the domain of probability that a system of credit interchange, capable of national if not of international application, may ultimately be adopted, and that thereby the ends of trade may be fully served without the necessity of imposing a burden upon the participating members.

Such a system has, in fact, been tried in a small way, sufficiently, it is believed, to prove that it is thoroly workable and efficient. Among other features it contemplates making inquiries obligatory whenever certain circumstances arise. It also demands that each inquiry be a report, in the sense that it shall contain one or more items of information affecting the credit title of the person or firm in question. Tho it is not feasible here to describe this plan in detail, it may be said that the reasoning upon which it is founded is somewhat as follows:

1. Relevant credit information in the matter of

commercial transactions is that which deals only with abnormal transactions.

2. Abnormal credit transactions, as that term is here used, includes the seeking of new credit as shown by the placing of first orders or of materially increased orders.

3. Delinquency—the owing of past-due accounts—constitutes another abnormal transaction or condition, and is therefore relevant credit information.

4. Where information covering abnormal transactions is promptly conveyed, all information relating to merely normal transactions, such as the buying of goods in the usual quantities as measured by past dealings and the paying of bills according to terms of sale, is not relevant credit information, since it is of no particular value to the inquiring credit giver.

5. By eliminating all normal or purely favorable information, more than nine-tenths of the total volume of credit information which is now being collected and distributed, may be dispensed with, and the work of the credit department thereby be made correspondingly lighter, simpler and cheaper.

6. The cost of participation in such an interchange system may be made so low as to constitute no barrier whatever to an entirely free use of the system, so that no unfavorable symptom in the debtor's condition may escape the creditors' notice.

From the foregoing the reader will see that under this system the files of the central office will not be burdened with information recounting normal credit

transactions, such as regular purchases and regular payments. The only source from which the bureau's information is drawn is the members' inquiry tickets, which in turn record only abnormal credit data, as just described. This being the case, it follows that the central office will have less than one-twentieth of the usual mass of credit information to care for, by which fact alone the workable limits of the interchange system are automatically enlarged some twenty times.

12. *A system based on abnormal transactions.*—The essence of this system lies in the fact that all the information received and dispensed is of a negative or unfavorable character, since it is a record of new credit sought and of slow payments. Opportunity is given the inquirer, however, to indicate by a check mark upon the inquiry ticket whether, in the case of an old customer, the last bill was discounted, paid at maturity, slow, or collected by draft or attorney. Only those transactions that involve new or considerably increased credit are reported.

The peculiar value of the information given out by the central office lies chiefly in the fact that such information is not based upon anybody's opinion, as for example that of an agency reporter, nor does it have any reference to what the dealer may say about himself—either or both of which may be at variance with existing conditions. On the contrary, such a report is a concise and uncolored record of actual transactions, being made up wholly from the informa-

tion furnished by the inquirers at the time their inquiries were made.

Accordingly, the satisfactory customer—that is, the retailer who always buys in normal amounts from the same supply houses, and who pays his bills with regularity—will not appear prominently in the files of the interchange office, for the simple reason that no one has had occasion to inquire about him. The unsatisfactory customer, on the other hand—that is, the retailer who is habitually slow with his creditors, and who for that reason is always compelled to seek new credit—is likely to have a great deal of information recorded about himself, since in his case, and under the rules of the system, each slow payment and each request for new credit will have brought an inquiry, accompanied by a statement of the facts that caused the inquiry to be made.

18. *Growing recognition of credit interchange.*—Inquiry made of a number of prominent manufacturers and distributors in various parts of the country shows that the value of credit interchange is today duly recognized by all progressive manufacturers and merchants. Without exception, these houses were found to be participants in some form of ledger-experience system, either thru one or more agencies, or by means of direct reciprocal exchange with other houses. This is not at all surprising in view of the freshness and reliability of the information that may be obtained in this manner. It indicates, moreover, that in the future the search for

relevant credit information will be increasingly in the direction of the credit seeker's present activities—his purchases and his payments, rather than his possessions and antecedents.

This tendency is wholly salutary and indicates a growing comprehension of the true basis of commercial credit.

### REVIEW

What features of credit information are covered by so-called ledger experience?

What are the chief advantages of a credit-interchange system as compared with other means of obtaining credit information?

What is credit clearing, how is the system operated, and what is its inherent defect?

In what items of information may relevant credit information generally be sought?

## CHAPTER VIII

### ANALYSIS OF CREDIT INFORMATION

1. *The financial statement; merchandise on hand.*  
—When all available credit information has been collected, the most important part of the credit department's work still remains to be done, namely, to analyze this information in order to reach an intelligent conclusion. We shall consider here some of the chief items that appear on the financial statement forms that are now commonly used. (See forms on pages 74–81.)

Cash value of merchandise on hand is necessarily one of the important asset items. In examining this item, we should consider first of all its size in relation to other asset items and to annual sales. If it appears to be disproportionately large, the item becomes a subject of careful inquiry. It may indicate an overstocked condition which not only constitutes a real danger in itself but reflects unfavorably upon the business ability of the merchant.

The value of stock on hand should always be compared with volume of annual sales, in order to obtain some idea of the number of times the stock is turned in the course of a year. If the normal turnover in the line of business under investigation is known,

such comparison will show in a general way at least whether or not the business is efficiently managed.

The next thing to be noted in connection with the merchandise stock is how it has been inventoried. Is the stock all fresh and salable so that it may be disposed of in the regular manner, without resort to special sales or to unusual and expensive advertising, or does it represent, in part, old and unsalable goods?

If the stock consists in part of unfinished goods, or of goods in process of manufacture, how much of each? Is the raw material inventoried at current market prices?

2. *Notes and accounts.*—The custom, which at one time was popular, of giving notes for merchandise has largely gone out of use. Today, with the exception of a few lines of which the building and contracting trade and the agricultural implement trade are examples, the retail dealer buys his goods on open account, tho it is not improbable that open accounts will gradually be replaced by trade acceptances. The appearance of notes receivable in a manufacturer's statement therefore generally prompts an inquiry as to what they are for. They may represent old and uncollectable debts, long carried and renewed again and again, they may be notes given by a member of the firm for money advanced him, or they may represent other items of such a character that the notes cannot be considered good paper.

Accounts receivable should, in common with merchandise, be considered in its relation to the amount

of annual sales as well as to the credit terms which obtain in the trade. If the proportion of accounts receivable to annual sales is unduly large, a lax collection policy and lack of financial ability on the part of the management are implied.

It is also important to know how the cash value of these accounts has been estimated. Any attempt to pad the statement will almost certainly appear here.

Before deciding to grant credit on these accounts without further security, it is always well to inquire whether they, or any part of them, have been pledged for loans.

3. *Cash on hand or in bank.*—This item should be large enough to permit the necessary freedom in the financing of the business. A small amount of cash where the volume of sales is large, and when accounts and bills payable are correspondingly heavy, means that the dealer is courting danger. Any little flurry in the market may send him scurrying for funds while the smallness of his bank balance deprives him of the right to demand accommodation from the bank. Large and otherwise well-managed concerns have been known to place themselves in this position and to have experienced the greatest difficulty in financing themselves when times of stress suddenly overtook them.

Unless a growing volume of sales is accompanied by a corresponding increase in the item of cash on hand or in bank, there is strong indication of inferior financial management.

4. *Fixtures, machinery, etc.*—The realizable value of assets placed under this heading is not easily determined apart from an investigation of the several items from which they are made up. As a rule, such values must be heavily discounted.

The accurate valuation of goodwill, patents and trade marks is always extremely difficult and often wholly impossible. For that reason the merchandise creditor will not ordinarily consider them in his estimate of a customer's assets.

5. *Owing for merchandise on open account.*—This item must be viewed in its relation to the volume of sales and to accounts receivable. It should also be considered in connection with bills payable. If the last item is large, accounts payable should be small, on the assumption that the proceeds from bills payable have been used for discounting merchandise bills.

Where this item is separated into amounts past due and amounts not yet due, a further insight into the financial methods of the concern is afforded.

6. *Owing to banks and to relatives.*—The items showing debts to banks and to relatives and friends not only show how much is owing, but indicate the dealer's ability to borrow in case of necessity. Possibly the banks have already been used to the limit of their willingness.

7. *Outside assets.*—When outside assets consist wholly or largely of real estate, they had better not be considered as a basis for merchandise credit. At best they are slow assets and difficult to realize upon

in case of forced liquidation. Frequently such assets are hedged about with conditions that make them wholly unavailable for merchandise creditors. While they are not to be thrown out as of no value, since they sometimes remain when other assets have disappeared, they should not ordinarily be included in an estimate of a merchant's title to commercial credit.

This item, however, affords an insight into the nature and extent of the merchant's investments. If these investments are of such nature as to demand the owner's active supervision, they may seriously interfere with his giving proper attention to his regular business, just as they may prove a drain upon his funds and thereby hamper—possibly even cripple—the business for which he is seeking credit. If the outside assets appear large an explanation should be asked.

8. *Analysis of agency reports.*—In a former chapter we noted that credit title is determined by the presence of business ability, financial strength and moral integrity, or the "Three C's"—capacity, capital and character. We shall now examine in the light of these three factors, a few credit reports of the kind that comes to credit men's desks in the ordinary course of business.

9. *Report on a manufacturing firm.*—The following is a Dun report on a manufacturing firm and contains several items of importance in connection with the determination of existing credit title.

Brown, R. S., and Company.      Scranton, Pennsylvania.  
Mnfrs. Trunks.

Brown, Robert S.  
Harris, Charles H.

June 15, 19—.

The business was started by the above partners and one Fred Carlson, some six years ago, and upon Carlson's death, which occurred a year or two afterward, Brown and Harris acquired his interest for \$2,700 cash, paid to his widow.

The remaining partners have worked in the same line of business for a number of years, both here and in Philadelphia. They are both middle-aged; Brown is married and Harris is a widower. Enjoy a fair reputation and are considered to possess only fair business capacity.

Repeated requests for a statement of their financial condition have been ignored. Are not inclined to talk much about their affairs.

The former owners of the plant failed in business, and their predecessor, who was the builder of the plant, is said to have lost money on it. The present owners bought the plant for \$12,500. Appear to be doing a fair business, though it is generally believed that they are not making substantial headway. The shop is running full time and employs from twelve to eighteen hands. Carries a fair stock of lumber and other supplies. Brown owns his residence, which he values at \$5,500 and which is mortgaged for \$3,000.

Harris' own business property is valued at \$8,000, mortgaged for \$5,200.

One supply house of whom inquiry was made, reports that bills are paid with a fair degree of promptness. Another reports them slow pay, altho it is willing to sell them in moderate amounts. Believes they are not making sufficient margin of profit on their product.

10. *Analysis.*—Applying to the foregoing report the test of capacity which, as will be remembered, we

divided into technical and financial, we note at once that the firm is credited with possessing only "fair" ability, from which we gather that their business ability is really poor, tho their skill as practical trunk-makers may be excellent. This conclusion is strengthened by the further evidence that altho they have been in business for six years, the partners appear to be merely holding their own and are making no appreciable headway. This condition is readily accounted for if, as the trade believes, their product is sold on too close a margin of profit—a circumstance which lends additional support to the opinion that the partners are men of small business ability, as is also suggested by their refusal to submit a financial statement.

It is not doubted that their technical ability as trunkmakers is satisfactory. Their long experience must be accepted as sufficient guaranty of that fact. The ages of these partners must also be regarded as being in their favor.

Under the second C—capital—the information is not sufficient for us to form an intelligent opinion. We know that six years ago the business was bought for \$12,500, but in the absence of a financial statement we have no means of knowing whether the assets of the business at the present time total that amount.

The information before us does not indicate whether the business premises are owned by the partners or merely leased by them. The supposed equity

in the properties of the individual partners should not be taken into consideration as a basis of credit. Nor do we know whether the plant is fully insured—not even whether it is insured at all.

Under the third C—character—we note that the partners are said to have a “fair” reputation, which implies that there are things in their history which show them to be not wholly upright or trustworthy. This makes us cautious. There is nothing in the report to indicate that the partners gamble, drink, or neglect their business, nor are we warranted in concluding that they are extravagant, either in their personal or in their business expenditures. But we do know that they are somewhat slow in paying their bills—in the words of the report, only “fairly prompt.”

To sum up our analysis, we find that the partners business ability is not such as to give assurance of the ultimate success of the business. As to their capital, we are not sufficiently informed either as to its amount or condition (quick or slow assets). It is true that two creditors declare themselves willing to continue selling the firm, but it is highly probable that these creditors are in possession of certain information that is withheld from us. Until we know what the firm's assets and liabilities are we cannot be certain that there is capital sufficient to guarantee us against loss.

As to the question of character, we unfortunately

lack definite proof that we are dealing with men of proper moral standards.

Under the circumstances we are not warranted in accepting the firm's orders except on a cash basis. It is quite probable, of course, that a first bill of relatively small amount would be paid, but even on that eventuality we cannot afford to take chances. If our customers will not open their hearts to us and give us their confidence, they cannot in reason expect us to open our stock rooms to them and give them possession of our merchandise. Until we have fuller and more satisfactory information we shall decline the order.

11. *Report on a general clothing business.*—The following is a mercantile agency report that was issued on a firm of retail clothing dealers.

John C. Ferguson and Brother.                      Syracuse, New York.  
Clothing, Shoes and Men's Furnishings.

John C. Ferguson  
Allan C. Ferguson

Are unmarried men, aged respectively forty and thirty-eight. Came here about five and a half years ago from Buffalo, N. Y., where they had been employed as clerks in the same line of business. They bore a good reputation in Buffalo and since coming here have been attentive to business, temperate, and are well regarded by the trade. They are conservative in their purchases, economical in their expenditures, and display good business judgment.

On March 1st, 1913, and on March 1st, 1915, their total assets and liabilities, as shown in the statements of those dates, were respectively:

Assets .....	\$41,213	Liabilities .....	\$ 8,763
Assets .....	\$59,468	Liabilities .....	\$19,420

Under present date they submit a statement from inventory of March 1st, 1916, which shows:

<i>Assets</i>	
Merchandise on hand .....	\$46,752
Book accounts (good) .....	1,750
Cash on hand and in bank .....	1,520
Furniture and fixtures .....	3,900
Store .....	7,560
<b>Total assets .....</b>	<b>\$61,482</b>

<i>Liabilities</i>	
For merchandise .....	\$9,600
Loans from bank .....	2,500
<b>Total liabilities .....</b>	<b>\$12,100</b>

<b>Net worth .....</b>	<b>\$49,382</b>
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Their statement is accepted as correct, according to their books, but it is believed that their stock cannot safely be valued at more than \$38,000. It is likewise thought that furniture and fixtures should not be considered worth more than \$2,000. Their store is being extensively remodeled, involving considerable expense, which fact, taken in connection with the other items, is believed to bring the net total worth down to about \$32,000, which may fairly be accepted as a basis for credit.

They are doing a very fair business and meet their obligations to the trade with promptness, hence enjoy a liberal credit.

Three houses selling them report as follows:

- (1) Credit up to \$4,000. Now owe us \$2,800, not due. Always pay promptly. Usually discount their bills.
- (2) Check their orders up to \$3,000 in sixty days. Pay promptly; take discounts. Now owe \$2,200, not due.

(3) Have sold them for years. Last year sold \$9,000. At present owe us a little over \$2,000, which is not yet due. Invariably prompt; nearly always discount.

12. *Analysis.*—This case presents no great difficulty, even tho some desirable information is lacking. The information regarding business ability is distinctly favorable. These brothers are both experienced men in their line and evidently understand all the technical features of their business. That they also possess sufficient financial ability, appears from the fact that they are always able to take care of their maturing obligations. Considering the amount of their capital, their outstandings appear small, indicating that they give credit with caution and that they are good collectors. This enables them to take advantage of cash discounts.

The capital of the firm is also satisfactory. It is more than probable that it represents the savings of years, accumulated by the brothers with a view to starting a business of their own. If this is the case they are doubtless accustomed to live well within their means and to practise economy and frugality.

We also note that the larger part of the firm's assets are "quick," which makes them easily available for the satisfaction of creditors in case of unexpected difficulties.

We could wish to know the amount of annual sales, as that would show us how often the partners turn their capital. We assume, in the light of other data, that they turn it about three times a year. We are

likewise without information as to the amount of insurance carried, but we must assume that consistently with their conservative and prudent management of the business the matter of insurance has not been overlooked.

The integrity of the partners can be judged by their reputation, which is shown to be favorable both before entering business on their own account and after. Their industry, economy and promptness are well attested.

Under the circumstances we shall be justified in extending a line of credit in keeping with their rating, which is E-2 (Dun) and which gives them an estimated financial strength of from \$20,000 to \$35,000, and shows their credit to be "high." (See key to Dun ratings on Page 102.)

13. *Report on a grocery business.*—The following report is one that was furnished by R. G. Dun and represents a situation that is by no means unusual.

Roberts, William S.  
Grocer.

Long Island City, L. I.

Has been in business here during the last seven years. Before coming here was a clerk in the same line. He is about forty years old and married. Is said to have begun business with less than \$800, tho three years later failed with assets of \$2,000 and liabilities of almost \$3,000. Settled with creditors at fifty cents on the dollar and began business anew. The following year a fire destroyed his stock, valued at \$2,500 and insured for \$1,700.

Statements rendered by Roberts during the last four years show the following totals:

# ANALYSIS OF CREDIT INFORMATION 145

	<i>Assets</i>	<i>Liabilities</i>	<i>Surplus</i>
1912 .....	\$1,875	\$ 650	\$1,225
1913 .....	2,280	860	1,420
1914 .....	4,375	1,850	2,525
1915 .....	6,000	2,700	3,300

We now have the following signed statement of his financial condition:

<i>Assets</i>	
Merchandise .....	\$ 2,800
Accounts receivable .....	3,100
Cash on hand and in bank .....	425
Furniture and fixtures .....	600
Horses and wagons .....	500

Total business assets .....	\$ 7,425
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<i>Liabilities</i>	
For merchandise not due .....	\$2,150
For merchandise past due .....	750
Note payable .....	600

Total business liabilities .....	\$ 3,500
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Surplus in business .....	3,925
Equity in residence .....	1,000

Total worth in and out of business .....	4,925
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Insurance .....	\$ 2,000
Yearly sales .....	28,000
Rent of store .....	1,200

It is not believed that his stock will exceed \$1,900, and his book accounts are also thought to be fully twenty-five per cent larger than the collectable amount.

Other items in his statement believed to be about right,

and it is felt that his net worth is not far from \$2,000. His business seems to be in fair condition and he is believed to be making some headway. His account is generally considered satisfactory, the investigation shows him to be slow with several creditors. Three principal creditors report as follows:

(1) Credit up to \$750 at thirty days. Owes now \$550, of which \$150 is nearly thirty days past due.

(2) Check orders up to \$500 at thirty days. Owes \$400, \$125 is ten days overdue.

(3) Extend a line of about \$700 at thirty days' time. At this time owes nearly \$600, of which \$200 is past due.

14. *Analysis.*—Here is a case of the kind which credit men often meet and upon which many are willing to take a chance. The business appears to be rapidly on the increase and the proprietor is reported attentive to his business interests. We also notice that he is obtaining credit without difficulty from other houses. We shall not forget, however, that an increased volume of sales does not in itself guarantee the prompt payment of bills. Nor shall we feel compelled to give credit just because other houses do so. Let us examine this case in our usual way.

Mr. Roberts is credited by the reporter with possessing only fair ability, which is merely another way of saying that he is an inferior business manager. This assumption appears also to be well supported by his own statements.

Too large a share of his capital is in the form of book accounts, showing that he extends credit accommodation with a very free hand. As we have seen, the liquid value of book accounts in the grocery

business is only about forty per cent. It follows that in case of failure his assets would shrink very materially.

His merchandise debts are larger than his stock on hand, and he is evidently seeking to do a larger business than his capital justifies. He is top-heavy, and may easily blow over in a business "squall." His equity in the residence property may, for our purpose, be left out of consideration altogether.

To sum up, then, our applicant is weak on business ability, his capital is insufficient for his business needs, and as for his character we have not sufficient knowledge to feel assured. If he is slow with other creditors, it is likely he also will be slow with us, and we shall do well to bear in mind that while slow payments do not necessarily imply that failure is impending, they always precede such an event. Everything considered, we are not justified in checking this order.

## REVIEW

In considering a financial statement submitted as a basis for mercantile credit, what particulars should you wish to know about accounts receivable? Merchandise on hand? Annual turn-over?

To what extent do you insist upon "character" in an applicant for mercantile credit, if assured that his business ability is good?

Assuming that a certain storekeeper's personal integrity is known to be above question, but that other information about him is not at hand, how would you treat a request for credit coming from him?

What kind of credit information do you expect from your traveling salesmen?

## CHAPTER IX

### ANALYSIS OF CREDIT INFORMATION

(CONTINUED)

1. *Report on a dry-goods business.*—At times, owing to the reticence of the merchants interviewed, or to the difficulty experienced in obtaining outside information, little information is available save that which may be drawn from uncorroborated financial statements. The following report illustrates that condition.

Nonpareil Dry Goods Company.

519 Brook Street,  
Newark, New Jersey.

Bertrand L. Fox, President.

Arthur B. James, Vice-President and Treasurer.

Jeremiah Johnson, Secretary.

Incorporated under New Jersey laws April 1, 1908, with authorized capital of \$6,000, increased one year later to \$15,000.

B. L. Fox is forty-five years old and married. Formerly employed as clerk in several local dry-goods stores.

A. B. James, thirty-nine and married. Has held present office since company was formed. Formerly confidential clerk with Harmon and Company of this city, manufacturers of neckwear.

J. Johnson is about thirty-three and unmarried. Formerly engaged in general storekeeping at Summit, New Jersey, where his reputation was good.

On January 17, 1909, a fire destroyed part of their premises, involving a loss of \$6,000, said to have been fully

## ANALYSIS OF CREDIT INFORMATION 149

covered by insurance. Shortly thereafter the capital stock was increased to \$15,000 which, it was claimed, was fully paid at the time. Subsequent statements show as follows:

	<i>Assets</i>	<i>Liabilities</i>	<i>Surplus</i>
January 1, 1911.....	\$38,631	\$11,752	\$26,879
January 1, 1912.....	38,042	14,716	23,326
January 1, 1913.....	50,857	26,598	24,259
January 1, 1914.....	53,916	35,817	18,099
January 1, 1915.....	51,603	38,433	13,170

A signed statement of the company's condition on January 1, 1916, showed:

<i>Assets</i>	
Merchandise on hand .....	\$49,966
Accounts receivable .....	61,293
Cash on hand and in bank .....	2,561
<b>Total assets .....</b>	<b>\$113,820</b>

<i>Liabilities</i>	
Accounts payable .....	\$60,967
Notes payable .....	20,714
<b>Total liabilities .....</b>	<b>\$81,681</b>
<b>Surplus .....</b>	<b>\$32,139</b>
Insurance carried on stock .....	34,000

The following information was obtained from prominent houses:

- (1) Sell up to \$800. Pays fairly promptly.
- (2) Credit \$1,000. Payments tardy.
- (3) Sell up to \$1,500. Very slow. Are closing account.
- (4) Sell up to \$500. Bill met promptly.
- (5) Have sold up to \$2,000. Very slow pay.

**2. Analysis.**—This report tells us little about the capacity of the management except what we may

gather from the corporation's annual statements. Evidently the concern is not at this time making any headway. On the contrary, a comparison of the statements indicates that it is going down-hill. Accounts receivable form a large item and indicate (in the absence of other information) that a very liberal credit policy is being followed. What portion of the outstandings is considered good we are not informed. It is not impossible that under forced liquidation the present surplus would dwindle to a very small amount—it might even disappear altogether.

The trade information is conflicting, showing that some creditors are being paid promptly while others are made to wait for their money. We also note that where purchases are large payments seem to be slow, and that the cases which show prompt payment are those in which purchases are light. This fact suggests that the company pays cash for necessities only, and that it obtains as much of its goods as possible on long-time credit. We know but little about the character of the corporation officers, and do not feel that the present information is sufficient to justify us in O. K'ing the order which amounts to about \$300. We therefore send a request to a local attorney for a quick report upon the corporation, using the printed form shown in a former chapter and accompanying our request with one dollar in currency. In the course of three or four days we have the attorney's report which throws considerable additional light upon the case. We learn, among other things, that the at-

torney has at this time for collection three claims against this corporation, which claims amount to over \$900 and which so far it has been impossible to collect by ordinary means. He intimates that to file suit at this time might precipitate bankruptcy proceedings and that he prefers, if possible, to collect the claim by persistent dunning.

We also learn that the management is not harmonious, and that the president has several outside ventures in which he is interested. The secretary, upon whom the management of the business principally falls, is spending several hours each day in local pool rooms and has lately become a notorious tippler. The vice-president is in poor health and has gone to the South to recuperate.

Upon receipt of this information our mind is quickly made up. While the business is going we should probably be able to collect the amount of this order, but the element of uncertainty is too great to justify taking the hazard. Under the circumstances, our goods are safer in our possession than in the hands of our would-be customer. We accordingly decline the order.

*3. Report on boot and shoe business.*—Altho previous experience in business is rightly regarded as a valuable asset in the case of a retail merchant, cases are often found where a very fair degree of success is attained even tho the merchant lacked such experience. The following report (Dun) illustrates such a case.

# 152 CREDIT AND THE CREDIT MAN

Baker, Wm. C.

Boots and shoes.

Thriftville,

Union County, N. J.

May 15, 1915.

Is a widower about forty years of age and has been in business here since 1908, when he formed a partnership with Bertrand Lissick under the name of Baker & Lissick. About two years later the partnership was dissolved, Lissick retiring. Before coming here, Baker lived near Joplin, Missouri, where for several years he worked a leased farm, subsequently engaging in the express business and eventually came East. As far as known, Baker had no previous store-keeping experience. Since coming here, he has made considerable headway and is considered by the trade as possessing good ability. He is spoken of locally as a man of good habits and character. Signed statements for five years past show the following totals:

	<i>Assets</i>	<i>Liabilities</i>
July, 1911, .....	\$3,000	\$375
July, 1912 .....	3,500	200
July, 1913 .....	4,700	545
July, 1914 .....	5,400	625
July, 1915 .....	5,700	275

Under date of July 15, 1915, he submits the following signed statement:

<i>Assets</i>	
Merchandise on hand .....	\$3,500
Good book accounts .....	2,500
Cash in bank .....	600
Cash on hand .....	50
Total business assets .....	\$6,650
<i>Liabilities</i>	
Owes for merchandise not due .....	250
Surplus in business .....	\$6,400

He owns the store building and two lots valued at \$1500, clear of encumbrances. Insurance on stock and building, \$3000. Has never failed nor been burned out. Annual volume of business amounts to \$15,000.

Appears to have a very fair stock of goods, thought to be worth about the amount claimed. His outstanding accounts are said to be good and his indebtedness is thought to be correctly stated. He lives over the store. Allowing for exemptions, it is thought that \$5,000 is a fair estimate of his net worth. He appears to be doing a fair business, to which he gives close attention. Meets his bills promptly, and receives good credit. Five houses from whom he buys report as follows:

(1) Account reaches about \$100 on thirty days, and bills are discounted.

(2) Check moderate sums on regular terms, and bills are met promptly.

(3) Credit up to \$150 on sixty days' time, discounts being taken advantage of.

(4) Credit up to \$200 on sixty days, and bills are discounted.

(5) Check up to \$700 on sixty days' time, and bills are discounted.

4. *Analysis.*—No great difficulty is found in analyzing this report. Here is a merchant who under the head of "character" measures up well, and whose "capacity" also appears to be fully equal to the requirements of his business. Tho originally a farmer, he has now had eight years of experience in his present business, and while his business is not large, it is steadily growing. His liabilities are practically nil and he generally discounts his bills. In extending to him a credit of a few hundred dollars we are not taking any great risk. He is too cautious a merchant

to overbuy, and we are perfectly safe in extending him credit in keeping with the requirements of his business. The credit rating given by the agency is the highest given for the amount of capital he possesses.

5. *Advance report and salesmen's data.*—In not a few houses, especially of the larger kind, it is customary to obtain agency reports upon prospective customers in advance of the salesman's visit, and to compare such reports with the information furnished by the salesman in order to have a basis for prompt shipping of a first order. The following case is illustrative of the value of this procedure and is cited here as given, except that—in common with other reports herein reproduced—names of persons and places have been changed.

#### COMMERCIAL AGENCY REPORT

Simmons, Andrew.

Cloaks, D. G., Not's, Women's  
Furn'gs, etc.

Horton, Michigan,

502 Second Street.

August 11, 1915.

He is a middle-aged, married man and has been here in this line since March, 1912, prior to which he was in the general store business at Joliet, Illinois, and previously had experience in the same line at Newburg, Illinois, where he failed. For some time subsequently conducted business in his brother's name. He succeeded his brother, Joseph Simmons, having previously compromised his old indebtedness at from fifty to seventy-five cents on the dollar. His failure occurred twenty-three years ago, and of late years no criticism is known to have been made on that account. Interviewed in March, 1914, he submitted a signed statement

showing inventory of January 30, 1914, claiming merchandise on hand \$22,680.75; outstandings, etc., \$1,380; cash on hand, \$68; cash in bank, \$562; fixtures, \$1,500. Other personal assets consisted of notes, \$500. Liabilities: For merchandise not due, \$900; loans from banks, \$4,000; real estate at Joliet, \$6,740, mortgaged for \$2,600. Insurance on stock, \$8,000; on real estate, \$3,500. This statement was believed to be a fair showing of his condition from his point of view, tho somewhat subject to shrinkage in arriving at a realizable basis.

Interviewed under date of October 29, 1914, he stated that he had decreased his loans from banks as shown in statement of March, 1914, \$2,000; also that his stock was larger than formerly. He suffered a fire loss November 28, 1914, caused by a gasoline explosion, and under date of December 20 called and stated that about a month previously he arranged to instal a gasoline lighting plant in his store, such as he had previously used in Illinois, on which account all his insurance, which amounted to \$8,000, was canceled. When filling his tank with gasoline on the evening of November 28, an explosion occurred resulting in damage which he estimated at \$1,500. He had that day arranged for a loan of \$2,000 from the bank, and before the explosion that evening had mailed checks to thirty-two creditors, the amounts aggregating \$1,909.36. After the fire his store was closed for two weeks and he was unable to attend to business. As he had intended to complete the loan the next day, he had practically no balance in the bank and his checks went to protest. This, he said, was satisfactorily arranged, and on the reopening of the store the sales of three or four days brought in enough money to pay them all off with one exception—that being a bill of about \$150, where the creditor had crowded him. As soon as he reopened, he had the gasoline lighting plant taken out and put in electricity again and insured his stock for \$10,000. He has taken no inventory recently, but on December 23, 1914, he estimated his stock at just about \$1,500 less than it was in statement of January, 1914. He submitted a list

of his liabilities aggregating \$6,014.32, including \$2,000 to bank and covering claims of forty-one creditors, eight of which were for more than \$100, but none of them reaching \$1,000. Stated that he had \$600 in bank and that except for the loss of two weeks' business, his condition was not materially worse than it had been before the fire. Stated he had been holding sales and clearing off dead stocks, and expected to do a good business in January after the holidays.

His statement in regard to the trouble and to his present condition was accepted as correct. At this time he appears to be doing a good business; gives close attention to his affairs, and so far as could be learned he is meeting his current obligations as he agreed.

6. *Analysis.*—There is in the foregoing report nothing to show that the merchant is unworthy of confidence. His failure in business some twenty-three years ago is not held against him by the trade and no suspicion of trickery exists in that connection. His history, as far as known, shows him to have been willing enough to take care of his obligations, and his present inabilities may well have been induced by the unfortunate fire in his store.

The report does not enlighten us as to his business capacity, except that it shows him to have had experience in his present line. Without knowing the amount of his annual sales it is difficult to judge whether or not his stock is too large for his capital.

From the data furnished by his signed statement of January, 1914, and his oral statements of October and December of the same year, it would appear that his net worth, even if we disregard his equity in the

real estate at Joliet, should be in the neighborhood of \$15,000. Discounting this one-third, we still would have a credit basis of \$10,000. The fact that he is reported to be doing a good business and to be giving his affairs close attention, also that he is meeting his current obligations as he agrees, would dispose us to consider favorably the opening of an account with him. The salesman's report is therefore awaited with interest, as probably supplying information that will confirm our impression.

In due time the report arrives and reads as follows:

#### SALESMAN'S NEW-CUSTOMER REPORT

Amt. of order — <i>about \$310.00</i>	Date <i>Nov. 20, 1915.</i>
Sold to — <i>Andrew Simmons</i>	
Post-office address, <i>Horton</i>	State <i>Mich.</i>
R. F. D.	County.

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#### INDIVIDUAL OR FIRM

<i>A. S., Sole prop.</i>	Age? <i>about 55.</i>	Married? <i>Yes.</i>
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#### GENERAL INFORMATION

Kind of Bus? <i>D. G.</i>	Est. val of stock?
Condition of stock? { <i>Broken lines</i>	
{ <i>Old stock.</i>	
	Insurance? <i>Yes.</i>
How long in bus? <i>3 1/2 years</i>	Safe amt. to credit?
Est val. of R. E. (subject to debt) \$	consisting of
<i>Pays \$50 per month rental for store</i>	

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Character? <i>Good</i>	Bus. ability? <i>Doubtful.</i>
Store favorably located? <i>Yes.</i>	Stock well displayed? <i>No.</i>
Attentive to customers? <i>No.</i>	
Capable clerks? <i>Wife sole assistant.</i>	
Does banking with? <i>Horton State Bank.</i>	
Present crop prospects? <i>Good.</i>	

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**Buys from firms named below:**

*A. Hartman, Chicago.*

*Theo. Fass & Co., Chicago.*

*Felix Bros. & Co., New York.*

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Write your own opinion on the other side.

*W. F. Merritt,*

*Salesman.*

Upon the other side of the sheet we find the following notation:

Mr. Simmons is a peculiar and taciturn man, and I found it very difficult to obtain any information from him. His only assistant is his wife, who appears older than he, and who is quite talkative. She does not appear to be a good saleswoman, is tactless and untidy. The premises are not well kept, both the exterior and the interior being in need of painting and other repairs. Window display appears not to have been changed lately, and is poorly arranged. I visited the store twice during the day and found trade light. Three weeks ago a competitor started three or four doors above, with modern fixtures and new stock well displayed, and I am of the opinion that the newcomer will absorb a good portion of Simmons' trade.

My judgment of Simmons is that he is industrious and attentive, but lacking in ability. Does not appear to have any idea of how to gain and hold customers, but is selling on a close margin, which probably accounts for whatever trade he has. I took his order, but would advise a close investigation of his affairs before filling it.

Yours very truly,

*W. F. Merritt.*

The salesman's report in this instance decides the question. Mr. Simmons will be required to pay C. O. D. for any goods he receives from the house. The condition revealed in this report is one step toward

the bankruptcy court. While it is not improbable that the present order would be paid for before the crash comes, it will not be safe to take the chance. Moreover, after reading the salesman's report, a doubt is created as to the correctness of the figures contained in Mr. Simmons' statement to the mercantile agency. It is to be feared that if put to the test the assets would undergo a material shrinkage.

Accordingly, a letter is written to Mr. Simmons, in which he is courteously informed that in view of the absence of sufficient information about his credit standing it is hoped that he will consent to have this order filled with draft attached to bill of lading, unless he prefers to send his check to cover in order to prevent delay.

In this case, as a matter of history, the requested permission did not come—it was not in fact, expected, and the correctness of the credit man's attitude was further demonstrated when, in less than thirty days, the following notice was sent out by one of the large commercial agencies:

Simmons, Andrew. D. G. Horton, Michigan. December 16, 1915. There was filed in the clerk's office of the United States District Court on the 16th inst., an involuntary petition in bankruptcy by A. Morlik & Company of Chicago, Ill. A. I. Baumgarten, and Jacob Goldstone & Co. of Detroit, Michigan, in which they seek to have the above named declared insolvent, claiming to be creditors of the above in the sum of \$2,456.55.

## CHAPTER X

### CREDIT PRACTICE IN REPRESENTATIVE LINES OF BUSINESS

1. *General Observations.*—One of the first things that impresses the student of credit management is the dissimilarity between the credit terms in various lines of business. In one line we find terms of thirty days, in another twelve to eighteen months and in one line the credit period even reaches three years! In some instances the interval between seasons determines the credit period. In some lines certain articles are sold on four months while others are sold on thirty days. Again, among manufacturers or wholesalers within a given trade we sometimes find one who quotes certain credit terms, while another, less than a hundred yards away, sells the same class of goods on entirely different terms.

Despite this irregularity certain general rules with regard to the length of credit given in the various lines of business are apparent. For example, we note, first of all, that if the business is seasonal, as in the case of ladies' garments or millinery trade, settlement for purchases is generally made twice a year—spring and fall. Where the commodity is in demand the year round, or where its sale is not greatly affected

by the seasons, payment periods come more frequently, as a general rule. Articles that afford a liberal profit margin are usually sold on longer terms than those that are sold on a smaller percentage of profit.

Products for immediate consumption, such as articles of food, are almost always sold on short credit terms, perishable food being sold practically on a cash basis. Nearly everywhere, however, one finds considerable latitude not only in the matter of terms given but also in the degree of strictness with which customers are held to the terms agreed upon.

The credit terms that obtain in some of the more prominent lines of trade are briefly discussed in this chapter. It should be remembered, however, that local customs and peculiarities frequently effect material changes in credit terms. The following describes the credit customs that are prevalent in the larger cities of the East.

2. *Customary credit terms in the grocery business.*—The wholesale grocery business is compelled perhaps more than any other line, to deal with a large number of untrained and otherwise incompetent retail merchants. In our larger cities, particularly, where there are large foreign sections, many of the grocery stores are in the hands of foreigners who have little or no knowledge of the English language or of American business methods, when they begin business. As these merchants rarely have any capital worth mentioning, they necessarily depend upon credit at

the hands of the wholesaler for the goods which they buy and sell. As a result of these conditions, the abuse of credit terms is common in the grocery trade, and the return of goods for no valid reason is also a frequent occurrence. These strictures, however, do not apply to that large number of intelligent and businesslike retail grocers that are found in nearly every community.

Speaking from a credit standpoint, we may say there are three classes of goods sold by the wholesale grocer. The class which constitutes the larger part of the goods sold in groceries includes what are called "shelf goods." Such goods are generally sold on terms of thirty days net, one per cent discount being given for cash in ten days, or as commonly written, 1/10/30. In some sections, however, this class of goods is sold on terms of sixty days net and one and one-half per cent discount for cash in ten days, or 1½ 10/60.

The second class is made up of such articles as butter, eggs and (usually) sugar. On these goods the terms are thirty days net and no discount for cash. Sometimes when sugar is sold along with shelf goods, it is sold on the same credit terms as the latter, that is, with a discount for cash payment. The third class consists of teas, and these are generally sold on terms of three to four months, with a discount of 3 per cent for cash within ten days. It follows, therefore, that a single shipment of groceries may have to be billed

in three different ways, as when the goods shipped include all three of the classes here enumerated.

Investigation of a new grocery account is left largely to the local salesman. If he recommends the account, the order is generally filled without further investigation, except that the mercantile agency's rating book may be consulted. So largely is this practice followed that in many wholesale grocery houses the salesman is virtually also the credit man in his territory. He is expected to see that all accounts are promptly paid, and while he is not held legally or financially responsible for them, he is responsible in a moral sense.

Few wholesale grocers appear to insist upon the customers' strict observance of credit terms. Accordingly, the discount period is not infrequently lengthened by the customer without the formality of first obtaining the creditor's permission for an extension. Likewise are the thirty or sixty days, as the case may be, often extended considerably beyond the credit limit imposed by these terms. This evil is being vigorously resisted in certain other lines, but appears to have met but little concerted opposition in the grocery line.

**3. Customary credit terms in the meat and provision business.**—The large packing houses, such as Armour and Company, and Swift and Company, sell fresh meat to retail butchers. They also sell provisions, which designation includes hams, bacon, lard,

and barreled goods (barreled beef and barreled pork). Fresh meat is sold on what is called "cash terms," which in this business means that they are to be paid for within seven days after delivery. One week's purchases must accordingly be paid for during the week following, failing which the delinquent butcher may be refused additional supplies while that bill remains unpaid. Provisions, on the other hand, are sold on thirty days net, no cash discount being given. They are sold to grocers as well as to butchers.

The packing companies have a third class of goods to market, designated by the general term, by-products. Such by-products are chiefly soap, curled hair, glue, sandpaper and ammonia. Since these goods have a variety of uses, they are of course sold to various lines of business. Such goods are sold mostly on thirty days, tho soap is frequently sold on sixty days. The salesmen are looked to for information about their new accounts, and also for keeping all accounts paid up according to terms of sale.

4. *Customary credit terms in the hardware business.*—The metal trade is highly diversified and subject to many influences of which no account can be taken here. In general, however, what is commonly classed as hardware is composed of "builders' hardware" and "shelf hardware."

Builders' hardware is usually sold to contractors, many of whom are not financially strong and in view of the more or less hazardous nature of their business are not regarded as specially good credit risks. In

many instances, therefore, such contractors are required to pay 85 per cent of their month's purchases on or before a certain day of the month following—in some cases, the tenth day, in others the twentieth. Under this arrangement the remaining 15 per cent is not paid until thirty days after the completion of the building operation into which the supplies enter.

The regular credit terms in the hardware trade are 2/10/30, which means 2 per cent off for payment within ten days of invoice, or net thirty days. Considerable latitude exists, however, in the observance of these terms, a common practice being to give 2 per cent e. o. m. (end of month), which later term in practice means the tenth of the month following. While some wholesale hardware houses appear to insist upon a strict observance of discount terms, others are more liberal in this respect and permit several additional days to be taken without protest.

The terms 2/10/30 generally apply also to shelf hardware, except that on these goods some wholesalers quote terms of 2/15/30. Where, moreover, the retailer lives at a considerable distance from the supply house, it is not unusual for the latter to permit the cash discount to be reckoned from the arrival of the goods—which in some cases and under certain circumstances may mean an interval of one month or more from date of invoice.

The class of hardware supplies described as "auto accessories," is sold largely to proprietors of garages and repair shops. Usual credit terms are quoted on

these goods, but since not a few of the persons engaged in the business are financially irresponsible, and since the business itself is unstable, certain precautions are often taken. Thus, it is frequently deemed expedient to demand an advance payment of as high as seventy-five per cent of the amount of invoice. This, however, is a matter of local or individual conditions rather than one affecting credit terms in normal transactions.

5. *Customary credit practice in the boot and shoe business.*—The terms upon which footwear is sold to the retailer are almost uniformly 2/10/60—sixty days net, 2 per cent off for cash in ten days. In practice, however, it usually means 2 per cent for payment on or before the tenth of the month following. As a variant of these terms, 1 per cent for cash in thirty days, sixty days net (1/30/60) is sometimes quoted.

The foregoing terms apply also to “findings” or shoe store supplies, such as shoe strings, buttons, shoe blacking, shoe trees, etc.

The shoe trade is subject to seasonal influence, the heaviest demand occurring just before the Christmas and the Easter holidays. At these seasons it is often necessary for the manufacturer or jobber to extend the dealer's usual credit limit, tho the credit terms themselves are not thereby affected. Moreover, the seasonal demand frequently compels a manufacturer to fill orders a considerable length of time in advance of the stipulated date of delivery. Orders for fall deliveries, for example, are usually taken in the

spring; and as these orders accumulate, it is often found necessary to begin making up the goods early, so that the activities of the factory may proceed uniformly and that its facilities may not be unduly taxed by an avalanche of orders to be filled simultaneously. Inasmuch as storage, insurance, etc., on finished goods add materially to their cost, it is a common practice for the manufacturer to select from among his customers those that are financially strong and well established in business, and ship them their season's goods in advance, while of course billing the goods at the date called for in the order. In this way the customer is given the free use of the goods for two, three, or perhaps four months, while at the same time expense is saved at the shipper's end.

It is generally well understood, however, that no agreement exists between the parties to ship in advance, the manufacturer reserving to himself the right to do so or not, according to his own convenience. In practice it generally means that the same dealers receive the same privilege year after year.

Rubber shoes and boots are commonly marketed by the manufacturers thru shoe jobbers. The latter, in turn, sell the goods to retail dealers on a December 1 dating, with delivery from April 1. A discount of 1 per cent per month is given for pre-payment. To illustrate: let us say that a shipment of rubber shoes is made on April 1. According to the terms of sale the goods are billed as of December 1—eight months hence. If now the dealer, instead of withholding pay-

ment until the latter date, pays the bill at once, he is entitled to deduct a discount of 8 per cent from the amount of invoice. If he waits until May 1, he may deduct 7 per cent, June, 6 per cent and so on until on December 1, if he waits that long, he pays the amount without any deduction.

During that part of the year that lies between December 1 and April 1, rubber goods are sold on terms of thirty days net, or 1 per cent cash discount.

6. *Customary credit terms in the textile business.*—In its broadest sense, the word textile includes all goods that are woven, irrespective of the material from which they are made. Technically speaking, however, there are many divisions of this line—in fact there are frequently several branches within a single line. In this chapter only the more important divisions of textiles are discussed.

*Woolens* (piece goods), used by “cutters-up” for suits and cloaks, are sold variously on thirty days, sixty days and four months, with season’s dating, which is January 1 and July 1. If bought on four months the discount is 7 per cent, on sixty days 8 per cent (sometimes 9 per cent) and on thirty days 10 per cent. That is to say, on goods bought in August with season’s dating, there is given 10 per cent discount if bill is paid within thirty days after January 1—in other words February 1. If paid on March 1, the discount is 8 per cent, etc.

*Dress goods*, woolens or worsteds for ladies’ wear, are sold to manufacturers of cloaks, suits and dresses,

as well as to retail stores, tho of late years, owing to the increasing demand for ready-made suits and dresses, such goods are sold less extensively to stores than was formerly the case. The terms are usually 6/10/60, tho sometimes 7/10/60 are quoted. This means, in the former case, 6 per cent in  $60 + 10 = 70$  days; and in the latter, 7 per cent for the same period. Season's dating, January 1 and July 1.

*Cotton goods*, which includes nettings, voiles, printed and bleached cottons, are sold to manufacturers of shirt waists and underwear, and to jobbers and retailers. The usual terms are 2/10/60, season's dating, the latter being October 1 and April 1. Delivery is usually from May for October dating and from November for April dating. Some cottons, however, such as cotton goods for the shirting trade, are sold on 2/10/4 months. In some cases, cotton goods are delivered as early as February with a November 1 dating and with the usual discount of 2 per cent for cash in ten days thereafter.

*Velvets*, which include plushes, are sold chiefly to manufacturers of suits and to the millinery trade. Terms are usually 6/10/60—sometimes 7/10/60—with dating April 15 and October 15, in the case of the millinery trade. To manufacturers the dating is usually January 1 and July 1.

*Silks*, which also include satins, are sold to manufacturers of waists, skirts, suits, and also to the retail trade. The terms are practically uniform in this line, being 6/10/60 with dating of January 1 and

July 1. The date of delivery in the case of these goods is not quite so early, being rarely more than two months (sometimes only one month) before season's dating.

*Silk ribbons* differ from other silks only in that they are sold chiefly to the millinery trade and as such in common with velvets and other goods used by that trade, subject to dating of April 15 and October 15. As in the case of broad silks the terms are 6/10/60.

*Linens* are wholly imported goods. They are sold to retailers chiefly on what are known as "regular terms" of 6/10/60, which means 6 per cent. for payment in seventy days. When the quotation is "net terms," it is understood to be 2/10/60, which consistently means 2 per cent in seventy days. A third quotation is "net net," which means "no discount and no dating"—in other words, spot cash.

Other terms upon which linens are frequently sold are 3/10 e. o. m., which means 3 per cent off if paid within ten days after end of month. Again, in the term 3/10 r. o. g., the abbreviation means "receipt of goods."

At times linen goods are sold subject to delivery from the other side of the Atlantic. In that case the terms quoted are usually 3½/10 r. o. g.

*Shirts and collars.* The terms on which men's collars are sold appear to be more uniform than those which govern the sale of shirts. The former terms are almost invariably 5 per cent off in thirty days, or 6 per cent in ten days. Manufacturers of shirts, com-

monly quote terms of 2/10/60, and 6/10/60, the terms apparently depending somewhat, upon the class of trade to which the goods are sold. Some manufacturers quote terms as liberal as 8/10/60, while others are said to sell only on terms of "net ten days." Terms to jobbers are almost uniformly 2/10/60.

7. *Men's and boys' suits.*—Ready-made suits of the better grade are usually sold to the retailer on a sixty days' dating at 7 per cent off for cash in ten days thereafter (7/10/60), or four months net. Cheaper grades are sold on a sixty to ninety days' dating net.

Season's dating in this line is May 10 for spring term and November 10 for fall term. Deliveries for the spring term usually begin in February, and for the fall term in July. A common quotation of terms in this line is therefore 7/10 season's dating.

Some manufacturers of men's clothing quote 2 per cent in ten days, thirty days net, which in other cases is varied to read 3/10/30.

*Cloaks and suits* of the better grades are sold on terms of 7/10/60 (7 per cent in seventy days) which, when payment is "anticipated," equals 8 per cent in ten days. On cheaper grades of goods the terms are usually 2/10/60 or 3/10 net.

8. *Customary credit terms in the lumber business.*—The business of lumber manufacturing and selling is, as might be expected, highly competitive, since such operations are scattered over the entire country from east to west and from north to south. Many associations of lumber manufacturers and dealers have been

formed, and much has been done by these associations to foster the interest of the lumber trade. Uniformity of grading, dissemination of information relating to production and marketing of the product, etc., are the chief objects sought by such associations.

The National Wholesale Lumber Dealers' Association has adopted a uniform schedule of credit terms, of which the following constitutes the chief part:

Settlement to be made promptly on receipt of each car. Freight net cash. Balance by note at sixty days from date of invoice or less  $1\frac{1}{2}$  per cent discount for cash, if paid within fifteen days from invoice; or 1 per cent for cash if paid within thirty days from date of invoice. No discounts allowed after thirty days. If car is not received within the above discount time, and discount is desired, prepayment on account will not be held as acceptance of the shipment, and the right to make corrections and complaints will not be forfeited thereby. In making delivery to prices, cost of goods delivered at destination is guaranteed, but not against delay in transit. Claims for count or quality must be reported as soon as car is unloaded and tally proven. No claims allowed if not reported within ten days after unloading.

A majority of the accounts in the lumber business are settled by notes, tho the date of settlement is frequently made ninety days instead of sixty, as stipulated by the terms of the National Wholesale Lumber Dealers' Association. At times, the note is dated from the arrival and inspection of the goods instead of from date of invoice, which frequently adds considerably to the length of the credit terms. Credit terms are the same for both hardwood and softwood.

9. *Customary credit terms in the furniture business.*—The furniture business is peculiar in this respect that it is grouped around half a dozen centers where manufacturers' product is collected and where retailers gather to inspect the season's offerings. Exhibitions are held twice a year at intervals of six months at different points. Salesmen for wholesale dealers cannot carry "samples" but only photographs and drawings. These substitutes are unreliable as a means of determining the finish and workmanship of the articles, so that buyers find it necessary to visit the furniture centers at the season's opening and inspect the goods themselves. The illustrations subsequently used by the salesmen on their visits serve chiefly as reminders of what has already been examined at the exhibition.

The credit terms usually quoted by wholesale furniture dealers are 2/10/30—net thirty days, 2 per cent off for cash in ten days from date of invoice, or as is frequently the case, 2/10/60. It is stated on good authority that while these terms are almost uniformly quoted, they are not always strictly observed in practice, and that competition is frequently made the excuse for a considerable deviation from regular terms. Lack of cooperation among wholesalers is generally blamed for the absence of uniformity in the credit practice within the furniture trade.

10. *Customary credit terms in the jewelry business.*—While terms vary considerably in the jewelry line, the largest and best houses generally quote terms

of 5 per cent for payment in thirty days; four months net. These terms apply to gold goods of all kinds except plain gold rings, which are sold at thirty days net.

*Loose diamonds* are commonly sold on six to nine months, and settlement is usually made by note. At times considerably longer time is given—in a few cases as much as eighteen months being permitted. The latter, however, is exceptional, and is not regarded as approved practice.

*Mounted diamonds* come under the classification of gold goods, and are sold on the same terms as these goods.

*Silverware* is divided into two classes: "Flatware" and "Hollowware." Both classes are sold upon the same terms, ordinarily 2 per cent discount for cash in thirty days, and four months net (2/30—net 4 mos.). Plated goods, both flat and hollow, are sold on the same terms.

*Cut glass* is often marketed along with silverware. This class of goods is sold usually at thirty days net with a cash discount of 2 per cent for payment in ten days (2/10/30).

The foregoing description of prevailing credit terms in different lines of business is necessarily incomplete. The author's object, however, is not to cover in detail every trade or business, but rather to afford an insight into the manner in which credits are generally handled in a few leading trades.

## CHAPTER XI

### THE CREDIT MAN

#### 1. *Credit man's place in the scheme of business.*—

The existence of the credit man as a distinct functionary in business is a result of the development of that system of credit giving which in this country has grown up in connection with the sale of goods on open account. Matters of credit, in common with other questions of business policy and business practice, were at one time decided by the owner or general manager. But with the increase of retail stores within the reach of the jobbers' salesmen and with the growth of the present system of credit-giving the matter of passing upon a customer's credit title came to be a special function in the hands of a special official who could devote the necessary time and attention to making credit investigations. As competition grew keener and profit-margins grew smaller, the importance of the credit man in preventing losses became correspondingly emphasized in practice, until to-day he is rightly regarded not only as an indispensable factor in modern merchandising but as a constructive force in the scheme of business.

The best credit man is undoubtedly he who checks the largest number of orders with the fewest losses. We must remember, however, that a credit man

may err on the side of being too conservative just as readily as on that of being too liberal. He may be so afraid of sustaining a loss that he will check only the orders which he knows to be absolutely safe—orders from highly rated and well-known dealers. Such a policy would not ordinarily save money for the firm; on the contrary, it would in most cases result in a loss. For in turning down orders that came from less substantial dealers, the credit man would be depriving his firm of the profits on many orders that, if accepted, undoubtedly would be paid for according to terms of sale. On the other hand, a too liberal credit policy that permits the checking of orders without due consideration of the probability of their being paid, will most certainly increase the percentage of annual losses and correspondingly reduce the firm's ultimate profits on the year's trading.

In order to be of the greatest value to his house the credit man must accordingly steer a middle course. He must take some chances, altho these should never be blind chances. He must always firmly decline to check an order if a well-founded doubt exists in his mind with regard to the probability of the ultimate payment of the account.

It follows then, that only by ceaseless vigilance and thoro investigation of the conditions that surround the credit seeker's business—to which reference was made in an earlier chapter—can the credit man check the largest possible percentage of orders while keeping his losses at a low mark.

2. *The question of authority.*—Difficulties often arise because the authority given the credit man is not clearly understood by all concerned and clashes of authority ensue. There are some credit men who believe that their authority should be absolute, and that no one of coordinate rank or even of superior rank in the general organization of the business should question in any way the decisions of the credit department.

Unless the head of the firm is the direct head of the credit department, it would be an abdication of proper executive supervision to place such unlimited power in the hands of the credit man. There seems to be no good reason why the head of this department any more than the heads of other departments should be granted extraordinary power.

The effectiveness of an organization does not depend so much on placing one man above another, or of defining the exact limits of each man's powers, as in causing them to work together cordially and harmoniously for a common purpose. If one man is to dominate another let it be not by virtue of rules and orders, but by reason of a forceful personality. It is doubtful whether any hard and fast lines can ever be set up in so perplexing a situation as the relation of the credit man and the sales manager. If each tries to understand the other's point of view and has a sympathetic appreciation of what it is, they can be depended upon to reach a good working basis.

Many credit men have incurred the ill-will of the

sales department by arbitrary rulings in cases where there was at least room for doubt in favor of the customer. The capable credit man realizes that the real interests of the departments of sales and credits are identical. He knows that the success of the house depends upon the profitable sale of merchandise, and he realizes that in the promotion of this work the two departments are jointly interested, since the ultimate success of a department, like that of an individual officer or employe, is necessarily contingent upon the success of the house itself. The credit man should be among the first to recognize the necessity of cooperation among all departments, and should be guided by it in his attitude toward the department of sales.

Perfect candor, a spirit of democratic equality and interdependence, rather than an attitude of isolation and superiority, should characterize the credit man in his relations with the sales department. An explanation on his part of the reasons for his decision will generally go far toward removing any possible resentment in the sales department. If there is anything in the credit man's attitude that is antagonistic to the salesmen, it obviously hinders the necessary cooperation, and to that extent constitutes a detriment to the business as a whole.

3. *Attitude toward the customer.*—It is, however, chiefly by his attitude toward the customers of his house that the credit man's value to the house is determined. It is his duty to make their dealings with his house so pleasant and profitable that not only will

their accounts at all times be in a satisfactory state, but a continuance of their patronage may be expected from year to year. If the credit man's duties are intelligently apprehended and conscientiously performed, he may even develop the customers' ability as merchants, with a view to obtaining for them a stronger position in the local field and a larger net revenue from their annual sales. Of the latter we shall have more to say presently.

Modern American merchandising methods do not tolerate the old maxim, *caveat emptor*—"let the buyer beware." The slogan: "money back if dissatisfied," today governs the conduct of practically every department store and of a large proportion of other retail stores thruout the country. And while for obvious reasons it is not practicable for a wholesaler to permit a retailer to return goods at will and get his money back, yet good practice demands that the wholesaler stand ready to adjust, without question or quibble, any defects in merchandise or any loss which his neglect or error may have caused the retailer.

Upon the credit man the task of making such adjustments usually devolves. He should be able to make his customers feel that he is looking after their interests and that he will protect them in any dispute that may arise in which they have a real grievance. This confidence on the part of the customers goes far toward establishing and maintaining cordial and satisfactory trade relations between the wholesale house and the retailer.

The credit man's desire to please customers must not, however, be permitted to obscure his views or affect his sentiments with regard to the importance of observing the credit terms of the house—in other words, of meeting payment obligations promptly and fully. Nor should he ever assume the attitude of one who regards such promptness as a favor or as a matter to be governed by the convenience of the debtor. Strict observance of terms should be expected as a matter of course, and should be consistently reflected in the credit man's attitude on all occasions. Since a reputation for promptness in paying his bills is one of the strongest business assets a dealer can possess, it follows that if the wholesaler's credit man succeeds in instilling in the retailer a proper regard for such promptness, he is rendering him a distinct service. We shall see presently how such a policy may be carried out in detail.

4. *Mental qualities desirable in a credit man.*—The position of credit man calls for a person of executive ability. He must, first of all, be observant. There are many avenues thru which credit information of one kind or another reaches the credit man's desk. An apparently insignificant bit of news may have value as indicating the trend of things in a debtor's business. Such signs may be found in failure to take advantage of the cash discount or perhaps in buying in a new market, or in any one of a number of things the unusual character of which sounds a warning note in the ears of the alert credit man.

As an illustration of this ability to "put two and two together" may be instanced a case that occurred in a New York bank. A certain depositor, a small jobber in woolens, presented one day a dozen or more bills receivable for discounting. Among these was a note for \$275 issued by a local house rated by at least one of the large mercantile agencies as worth between \$200,000 and \$300,000, and as being a "good pay." Much to the surprise of the holder of the note the bank's credit man declined the offering without explanation. Upon being pressed by one of the bank's officers to give his reason for refusing the note, the credit man said in substance:

That the big house should buy of the small jobber at all is noteworthy. Under normal conditions such a house would have larger and better sources of supply. When therefore it turns to a small jobber for its necessary supplies, buying in small quantities and, of course, at higher prices, it throws out a strong hint that its credit is nearly, if not altogether, exhausted. This conclusion is strengthened by the fact that this well-rated house is compelled to give its note for the small amount involved. I conclude that if such a house finds itself unable to buy a small bill of goods on open account in the home market, it is upon its last legs and is tottering to its fall.

The sequel proved the credit's man's conclusions to be right, as within a very short time the affairs of the house were suddenly and shockingly brought to public attention thru the self-destruction of the proprietor.

Tho the house had succeeded—undoubtedly thru some form of deception—in keeping up its mercantile agency rating, it was in fact hopelessly insolvent.

A good memory is of great value to the credit man. He is constantly called upon to keep in mind a variety of facts regarding trade conditions, the history of many of his accounts, approaching due-rates and the like. While it would be a great mistake to try carrying all his information “under his hat”—especially in view of the fact that his enforced absence on account of illness or for any other cause would most likely prove embarrassing to his substitute—the credit man, by reason of the nature of his work, is constantly drawing upon his memory for important facts relating to the work of his department.

A credit man needs, moreover, a thoroly analytical mind. The ability to examine facts dispassionately and to form conclusions based strictly upon the evidence at hand, is necessarily of value to every one, whether he is engaged in business or not; but to the credit man such ability is indispensable.

An open mind, an unbiased judgment, and firmness in executing his policies—these are among the mental qualities that we look for in a man who presides over the credits of a business house.

5. *Moral and social qualities.*—To say that the credit man should be governed by high moral standards is merely to state what should be true of every business man who hopes to make a lasting success of his vocation. Yet the credit man, in his desire to

serve his house, is perhaps put to the test in this respect more frequently than any other business functionary. Not infrequently, for example, he is called upon to take the customer's side against the house—a duty which a morally weak man would be strongly tempted to shirk.

Always a man of his word, the competent credit man will make neither a promise nor a threat unless he is prepared to carry it out to the letter. To use courtesy and kindness is quite necessary if he would gain and hold the good-will of his customers. In fact, readiness to help an unfortunate dealer who needs assistance may be as much of a credit man's business policy as insistence upon the observance of credit terms under all normal circumstances. For a customer whose business by such means has been saved from extinction is not likely to withdraw his trade in favor of another supply house.

Social qualities which enable him to mix readily with all sorts of men and to be liked personally also form an important part of the credit man's equipment. A disgruntled customer—no matter whether or not there is sufficient reason for his displeasure—is a liability to the house, and may require very tactful and diplomatic handling.

6. *Special training.*—While the value of a good general education needs no emphasis, the credit man should have had also a broad business education. A knowledge of business processes, factory organization and office management is important. So also is

familiarity with distribution plans and selling processes. The latter involves, of course, also an understanding of advertising as related to marketing of products, and of the various avenues thru which the public is made acquainted with the manufactured goods.

Tho it is not necessary that he be an experienced accountant, the credit man should have a very fair understanding of accounting principles and methods, since he is constantly called upon to analyze financial or property statements issued by credit seekers. Balance sheets and profit-and-loss statements reveal facts of great importance to the credit giver. Not infrequently, the credit man is also in charge of the accounting department of his house, in which case he must as a matter of course understand both the principles and the practice of modern accounting, including an elementary knowledge of cost-finding principles.

In addition to his knowledge of production, marketing and accounting, the credit man requires considerable knowledge of financial subjects. Most likely, many of his customers are corporations, hence it is important that he should know something of corporation finance and the legal aspect of corporate business. Again, the credit man has more or less intimate dealings with the banks. He should therefore be acquainted with banking principles and banking practice in order to know how the banks can serve his interests most economically and efficiently.

Since money is a commodity that is bought and sold, much the same as other goods for which there is a fluctuating demand, and since prices in general are affected by the price of money, it follows that the credit man should have some knowledge of the current financial situation, the work of the stock exchange and the investment market. He may at certain seasons of the year have funds to invest, just as at other seasons he may take advantage of the low interest rate and borrow for current requirements. Without a fair knowledge of investment he will find it difficult to use the firm's funds and credit to the best advantage.

Insurance is likewise a live topic to a credit man. He will nearly always wish to make sure that the retailer to whom he extends credit has his store and stock adequately insured. For that reason, some knowledge of fire insurance, the various kinds of insurance policies, insurance companies, etc., is very desirable. In the same way, familiarity with real estate law relating to the holding and transfer of title is often of great value to the credit man.

A certain knowledge of law is of course indispensable to a successful management of the credit department. Such subjects as contracts, agency, negotiable instruments and bankruptcy, in addition to exemption and homestead laws in the states in which his house is doing business, should be known and understood well enough to guide a credit man in the ordinary transactions of his office. It is not meant by this that he should undertake to be his own lawyer, but

he should know enough law to be warned when he is approaching legal difficulties, so that he may summon competent legal aid in time to prevent loss.

Above all, the credit man should understand the subject of credit. This statement may appear so obvious as not to call for emphasis. This requirement, however, is not met by a mere familiarity with credit routine, as is often seen in the short-sighted credit policy of some houses. It is found rather in that broader view of the subject which takes cognizance of the presence of credit, not as a necessary evil but as a great boon, the right use of which promotes trade by facilitating the exchange of commodities and assures business permanency and freedom from commercial loss.

7. *The credit man as a business force.*—Aside from the immediate duties involved in checking orders and collecting credit information about customers, actual and prospective, the modern credit man finds a line of work awaiting him which fully equals these duties in importance. The manufacturer and wholesaler recognize more and more clearly that the best way in which to promote their own business is to promote the business of the retailer. In other words, if they can make the retailer a better merchant so that he sells more goods, they thereby make of him a larger buyer of their goods and a prompter payer of his bills.

A glance at the commercial mortality statistics will show how many retailers, especially in the rural dis-

tricts are in need of the help suggested. According to figures prepared by R. G. Dun and Co., there were in 1915, in the United States, more than twenty-two thousand commercial failures, with liabilities of more than three hundred million dollars. The significant fact in connection with the large number of annual failures is that about eighty per cent of them were directly due to the faults of the failing merchants. What these faults were, specifically, we shall see in a subsequent chapter.

Meanwhile, the question naturally arises: How can such faults be corrected, and how can dishonest dealers be eliminated as credit customers?

As a matter of fact, the deliberately dishonest dealer is rare. On the other hand, the hopelessly incompetent constitute a very considerable percentage of the smaller merchants of the country.

In the interest of sound business practice, the credit man should refuse credit to those who are incompetent, just as he should by every means at his disposal endeavor to make better merchants of those who tho inexperienced appear to be made of the right material.

More than a superficial knowledge of each dealer is required to draw the line thus sharply between good and bad. And even where there can be no doubt that a certain dealer is in need of help and guidance, there remains the problem of supplying such help in a way that shall prove effective without giving offense. Experience shows that if suggestions for the improvement of their business methods are tactfully pre-

sented, the majority of retailers are willing to receive them. Accordingly, certain wholesale houses have made systematic effort to learn in what particular departments of business their customers are deficient.

8. *A "business service" department.*—Among those who seem to have carried this work farthest, is the Moller and Schumann Company of Brooklyn, New York, varnish manufacturers. This company maintains a "business service department" under the direction of the credit manager. The object of the department, as stated by the manager, is "to help dealers in the conduct of their business by advice and counsel to avoid their going backward; to help them escape the courts; to avoid losing their money; in short, by suggestions and personal assistance, to help make them successful merchants."

The Moller and Schumann Company makes use of its salesmen in its effort to discover cases that require the aid of the business service department. Each salesman is provided with a report form upon which he checks the subject which, in his opinion, demand attention in the case of the dealers reported on. This form is as follows:

Customer's name .....  
Address .....  
Business .....

I find this customer susceptible to suggestion and my observations indicate that he could profitably use the services of the department. I have x'd the points I consider applicable.

Accounting	Delivery Systems
Borrowing Money	Insurance
Cash Discounts	Legal
Cash Sales	Partners or Officers
Buying	Taxes
Collections	Trade-papers and Organizations
Credit	Miscellaneous
	Dealer's Credit Rating

The form contains a number of subdivisions of these heads, so that the salesman may indicate as nearly as possible what particular form of service he considers most necessary.

Upon the receipt of such a report, duly checked by the salesman, the credit man either visits the dealer in person or sends him a letter—preferably the former. At other times, when such a course seems desirable, the necessary information is sent to the salesman in the territory, who thereupon takes up the subject with the dealer by means of a personal call.

The department finds its services in demand chiefly in connection with such subjects as accounting, credits, buying and selling, insurance, taxation and legal matters.

9. *Direct value of cooperation with customer.*—Obviously work of this nature, when the credit department is in a position to give it proper attention, is of distinct value as a means (1) of developing the business ability of the more competent, thereby making them better customers and safer credit risks, and

(2) of tying these dealers more closely to the house that offers such service.

Mr. H. C. Workmaster, of Pittsburgh, writing in the *Credit Men's Bulletin*, of this phase of the credit man's work, says:

Unfortunately the credit man who suggests such a policy is often met with the objection of expense; but my experience has been that I could secure enough business in addition to the valuable information I went after, to cover considerably more than my expenses, and besides being able to corral some overdue accounts which had stood as obstacles perhaps for several months to securing new business. One will be surprised at the number of "pick-up" orders that can invariably be secured in credit investigation excursions, orders which awaited the first man's arrival and which the customer had delayed in sending in.

Perhaps of even greater value is the information which by this means comes to the credit department of the wholesale house. In the words of Mr. Workmaster:

A credit man has the golden opportunity of scanning with his own eyes the stock and character of the man with whom he trades his dollars, and is in position to note the actions and habits of the man in his own place of business. In many cases, by a little tact, it is possible to derive from him a statement of his financial affairs which can be compared with stock under direct observation. In not a few cases I have been successful in securing such statements after the representative for the reporting agencies had been flatly turned down. Why is this? It is not because more tact was exhibited, but because of the credit man's peculiar position. He is able to make the approach from a different angle.

Meeting the objection that many dealers would resent such an approach as an intrusion the writer continues:

I have seldom left my customer with any but the best feelings, and with the exception of a few cases, I have been able to approach my people and handle their business after such a call, in a more friendly and intelligent manner. I have been able, very likely, to make a very small account a steadily increasing one.

### REVIEW

What is the chief test of efficiency in the management of a firm's credits?

What should be the management's attitude toward the credit man with regard to authority in his department?

Define the credit man's proper attitude toward the sales department, pointing out two mistakes of opposite nature which he should especially guard against.

In his desire to protect the interests of his house, on the one hand, and to gain and hold the good-will of his customers, on the other, what general principles should govern the credit man?

With what departments of business should a credit man be familiar, and why?

What activities on the part of the credit man contribute to make him a constructive force in business?

## CHAPTER XII

### WHY MERCHANTS FAIL

1. *General causes of failure.*—Inasmuch as the modern credit man is interested not merely in refusing credit to weak and failing dealers, so as to save his house from losses arising from unpaid accounts, but also, as described in the preceding chapter, in helping the inexperienced dealer to avoid the rocks upon which his ship of business is in danger of being wrecked, it follows that he is also interested in studying closely the various causes that contribute to business failures. Obviously, if the credit man is to be a successful business physician, he must first study the ailments for the symptoms of which he is to prescribe.

Statistics demonstrate that about eighty per cent of business failures are due to faults on the part of those who fail. Therefore such failures are to a large extent preventable. Until a relatively short time ago, however, little had been done by way of systematic investigation of the specific causes that shorten the business life of dealers and add to the economic loss annually sustained by the business world.

2. *Business mortality statistics.*—Mr. Stanley A. Dennis, in *System* for January, 1916, relates the re-

sult of an investigation of the duration of business enterprises in the town of Waterloo, Iowa. Some of his findings are startling. Basing his figures on the history of 266 factories in that town, the investigator found that the average life of a manufacturing business is only six years. He also found that about sixty per cent of factories close their doors within five years from the date of opening. Retail stores apparently fare but little better, since forty-five per cent of these, according to Mr. Dennis, become extinct within a similar period.

While these figures are not adapted to show accurately the frequency of failure, since causes other than business failure had to do with the closing of some of the enterprises and since local conditions also may have influenced the result, they are nevertheless believed to be sufficiently accurate to prove that a surprisingly large number of the persons who start in business, fail to succeed, and that many end their business career within a relatively short period.

But we are not to suppose that failures cease with the fifth year. According to Mr. Dennis, the length of life of thirty-three plants that were in operation in 1886 was as follows:

In business 5 years or less.....	17
In business between 5 and 10 years.....	5
In business between 10 and 15 years.....	5
In business between 15 and 20 years.....	2
In business between 20 and 25 years.....	1
In business between 25 and 30 years.....	0
Still in business .....	3

3. *Chief causes of failure.*—The two immediate and outstanding causes of business failure are overbuying and poor collection methods. Could these evils be eliminated it is probable that at least seventy-five per cent of present failures would disappear. It is interesting to note that in certain lines of trade, overbuying is found to be the chief cause of failure, while in certain other lines poor collection methods occupy first place. In the dry-goods business, overbuying is believed to be responsible for more than one-half of the total number of failures. But in the grocery business the predominant evil is poor collections. The hardware business seems to suffer about equally from overbuying and poor collections.

Next to the causes already mentioned, two others demand attention. They are (1) poor location and (2) bad accounting. In some lines of business, poor location is held responsible for fully one-quarter of the total number of failures. The success of a cigar store, for example, depends largely upon its location. It is well-known that the United Cigar Stores Company and other efficiently operated concerns, make exhaustive tests of location before opening a new store. Poor judgment here may predetermine failure.

The use of poor accounting methods is an evil that produces a number of costly mistakes, as will be shown presently.

Lack of capital as a cause of failure in business appears chiefly in connection with overbuying, since the

latter term simply means that the available capital has been tied up in slow-moving or unsalable stock. While this may be the fate of one dealer, another having no larger capital but exercising greater care in buying may make his capital suffice. The question is not always so much how large the capital is, as how carefully it is employed.

That inexperienced persons frequently undertake to start in business with insufficient capital is of course a well-known fact. But such a condition is generally discovered at once by the credit man who is called upon to analyze such a man's financial statement, and he accordingly grants credit with greater care. More frequently, however, it is only after a firm appears to have become established, as when it has done several years of apparently successful business, that its lack of available capital becomes manifest thru its inability to meet its merchandise payments. Upon examination it will generally be found that this lack of funds has been brought about either by too liberal buying of goods for which there was no present sale or by a lax collection policy.

The factors of location and accounting play an important part also in the longevity of manufacturing enterprises. It is observed that a common cause of early failure among such is found in wrong location. Frequently a plant is too far removed from the natural market for its product, or it may be that freight tariffs place it at a disadvantage in competition with plants more favorably located. When, however, fail-

ure appears later in the history of a manufacturing business, the cause may frequently be traced to faulty accounting. The neglect to figure adequate depreciation of equipment, or ignorance of the importance of an exact cost system, creates a false situation with regard to earnings. The vitality of the enterprise may gradually be sapped, until a sudden strain upon its resources reveals a condition of hopeless insolvency.

4. *Lack of enterprise.*—Experience shows that lack of enterprise is a common cause of failure in business, so common, in fact, as to be a contributing cause in the greater number of such failures. Inertia, laziness, “dry rot”—various names may be given it, but it all amounts to the same thing, namely, failure to take advantage of new conditions or opportunities, and persistence in doing things in the old way, when better, easier and cheaper ways are available. Many merchants apparently do not realize that the world is constantly moving onward and that they must move with it or stagnation will result.

5. *Lack of provision for upkeep.*—One way in which “dry rot” frequently manifests itself in a manufacturing business is in the management’s reluctance to instal modern and time-saving equipment or to spend the necessary amount of money in order to keep the old equipment in first-class order. In certain classes of machinery, inventions follow one another in such rapid succession that a machine that was new only a year or two ago may now be obsolete. In competition with plants having modern equipment,

the manufacturer who is "trying to get along with what he has" frequently discovers when it is too late, that he has been pursuing a "penny-wise and pound-foolish" policy.

6. *Poor display of goods.*—Reference has already been made to poor location as a contributing cause in the failure of manufacturing enterprises and retail stores. Wrong location is necessarily a handicap to any store that depends for success upon its ability to induce passers-by to enter its doors. Where, therefore, the location or the construction of the store is such as to prevent a favorable window display and store arrangement of the goods carried, the proprietor is deprived of a valuable aid, and may find the additional handicap too strong to overcome. He may seek to convince himself that Emerson's adage about the public making a beaten path to the door of the man who makes the best mousetrap, will surely apply to him and to his merchandise; but if so, his successful competitor is either not aware of that adage, or he prefers to rely upon suitable business premises as the best means of attracting and holding trade.

7. *Incompetent clerks.*—Of late years strong efforts are being made by the large retail, department and specialty stores to increase the efficiency of their salespeople. Not only are study classes being maintained for the purpose of making the clerks familiar with the goods carried in their departments and with the best methods of displaying and selling them, but such matters as the clerks' personal appear-

ance, their intelligence, cheerfulness, courtesy toward customers, tactful handling of those waiting to be served, etc., are also being thoroly studied. This is the natural result of the discovery that competent and obliging clerks are among the chief factors of increasing the volume of business and of establishing the reputation of the store. The dealer who, with cheap, incompetent and indifferent clerks, endeavors to compete for business with stores that employ truly efficient salespeople, has laid the foundation for ultimate failure.

8. *Wrong buying*.—It has already been pointed out that overbuying is one of the most frequent causes of failure among retailers. For this, however, the retailers are perhaps not wholly or solely to blame. Some manufacturers and jobbers conduct business on the principle of selling a retailer as large a bill of goods as he can be induced to buy. This is, of course, a short-sighted policy, and one that cannot but prove injurious to both seller and buyer. No dealer should buy, and no wholesaler should sell him, more goods than he can readily dispose of in the normal course of the season's trade. The dealer who buys in excess of normal demand needlessly ties up capital in stock upon his shelves, and therefore weakens—at times even cripples—his paying ability.

Not only with regard to quantity, however, but also in the matter of quality, style, patterns, color and various other factors may the buying be at fault. In the credit man's opinion, it is a strong point in a

credit-seeker's favor, that he is known to be a "careful buyer." By careful buying is meant buying in accord with the needs of the classes of persons who constitute the customers of his store. Goods that are readily salable in one store may not "move" in a store on the next street. It all depends upon the class of people who come to buy. Moreover, each season introduces a number of specialties—new goods regarding which no previous experience is available, but on which a larger profit is generally made than on staples. An error induced by too strong a desire for gain, in connection with the stocking of such specialties, may at the end of the season leave on the dealer's hands a quantity of goods that cannot be sold at any price, since the demand for them was created by a mere short-lived fad.

A few seasons' mistakes in buying, especially where the business is conducted with only a small amount of working capital, may readily exhaust both capital and credit, and leave the dealer in the bankruptcy court.

9. *Slow turnover*.—The peddler on the street who makes a living out of a capital of twenty-five or fifty dollars, must turn his capital a great many times in a year if he is to make a satisfactory profit. The greater the number of his turnovers, the larger his year's earnings. Similarly, a retail storekeeper's turnover is an important factor in gauging the permanence of his business, since the ratio of turnover directly affects the size of the capital invested. If the turnover is slow in a business where with proper man-

agement it ought to be rapid, it shows that too much capital is invested. It may be that when interest on capital is deducted from the year's earnings, the merchandising profit will be nil.

It will be seen that a slow turnover is directly connected with the manner of buying. If a merchant buys in large quantities when by buying oftener he can buy conveniently and economically in smaller quantities, he is clearly tying up capital and reducing the rate of his turnover. This is why the annual turnover must always be ascertained if we are to know accurately whether the business is earning a profit, standing still, or losing money. In some lines of business where profits on individual sales are small, as for example in the grocery business, the capital should normally be turned about ten times a year, while in others, where profits on each sale are relatively large, as in the case of specialties, one or two turnovers a year may afford a very satisfactory rate of profit.

A slow rate of turnover, considering the character of the business, helps to pave the way for delinquency and for subsequent insolvency. This condition, therefore, sounds a warning for the creditor house.

10. *Liberal credits and poor collections.*—The majority of retail stores sell on credit; even so-called "cash stores" frequently extend credit to a certain number of customers whose trade is desirable and who are in the habit of paying their bills once a month or at other regular intervals. Moreover, competition in

nearly all lines of trade is such that it is necessary to make it as easy as possible for customers to buy. Yet between extending credit wisely and unwisely, there is always a wide gulf, as usually becomes evident when attempts are made to collect the outstanding accounts.

Many retailers grant credit with a very free hand, apparently forgetting that no profit is made on a sales transaction until the goods sold are fully paid for. When to such liberal credit policy is added a poor and unmethodical collection practice, we have a combination that is capable of consuming all the profits in sight and of leaving a deficit at the end of the year.

11. *Inappropriate advertising.*—The efficacy of advertising is today generally recognized. Fortunes have been made thru judicious advertising; but fortunes have also been lost thru ill-conceived publicity. A business may suffer for lack of advertising or for lack of suitable advertising. It may also suffer on account of excessive, too expensive, or unsuitable advertising.

12. *Defective accounting systems.*—It is a matter of observation that many retail stores employ only the crudest and most inexact methods of keeping accounts. Aside from the fact that under such circumstances many credit sales are sure to go uncharged, and thereby involve a direct loss to the business, the dealer who is without a proper accounting system never knows what his actual condition is; never knows,

therefore, with certainty whether he is making a profit. He may, in fact, be playing a losing game.

Failure to figure correctly the cost of doing business has led many dealers to imagine that they were making a profit when in reality they were doing business at a loss. Many, for example, do not think of including rental for their land and buildings, when the business premises are their own. Yet legitimate and necessary expenses cannot be left out of the calculation without rendering it misleading. Again, many dealers overlook the obvious fact that if they devote their time and attention to their stores, they should charge the business with a salary for themselves, equal to that which they could earn if working for others in the same capacity.

Similarly, if a dealer's wife or children assist him in the store, their services become a proper item of expense. In many cases, however, these are not so entered at all. Accordingly, what the merchant may regard as a fair year's profit, may under such circumstances, disappear wholly and there may even be a deficit when these items of expense are properly charged.

Another important item of expense that is often ignored by the small dealer is depreciation on goods carried over. In certain lines, especially those affected by fashion, such goods may be worth only a fraction of their original value, but even where depreciation is not so marked, it nevertheless must be taken into account if the inventory is to show ap-

proximately the present value of the stock. Many a merchandise account, if measured by present value, would shrink uncomfortably. Strange enough, many dealers who are guilty of this practice are aware of that fact, but fear to face the situation squarely. It is a species of self-deception that some day is likely to end disastrously for the business, especially if buildings, fixtures, wagons, etc., are treated in the same lenient manner.

Other items of expense that often fail to receive proper recognition as such are losses from bad debts, from theft and other causes; incidental expenses, such as hauling, postage, office supplies, etc. There are, moreover, certain fixed expenses—light, fuel, insurance, taxes, etc.—which demand proper entry and distribution if the total cost of doing business is to be accurately known.

It might be objected by some that if a dealer's goods are sold at a profit and the money collected, it does not matter much whether all his book entries conform to the rules of scientific accounting. The answer to this, however, is that if the books present a false situation with regard to profits made, the withdrawals of funds by the proprietor are likely to be in excess of the amounts justified by the true condition of his affairs. To the extent that this is done, the proprietor is necessarily appropriating to himself as profits what has not actually been earned, hence he is constantly depleting his capital.

13. *Figuring profits.*—Many dealers deceive them-

selves into thinking that their selling prices permit substantial earnings to be made, when as a matter of fact, this is not the case. Some time ago the Burroughs Adding Machine Company of Detroit ran an advertisement that called for the solution of a simple problem in figuring profits. More than four thousand retailers answered the advertisement and sent in their solutions, but it was found that only eighteen out of every one hundred answers were correct. In other words, only about one dealer in six knew how to figure his profits correctly. This fact alone shows plainly enough that while even in the smaller towns there are many intelligent and thoroly capable retail merchants, there is a much larger number whose ignorance of the very elements of business success is such as to render their continuance in business over any considerable period of time extremely problematical.

14. *A common error in calculation.*—By way of illustrating the manner in which some retailers arrive at the selling price of their goods, the following will suffice:

Say that the cost of an article is \$4, and that the dealer knows his expense of doing business to equal 25 per cent of his sales. He desires to make a profit of 10 per cent. He proceeds in this manner:

Twenty-five per cent of \$4 is \$1; 10 per cent of \$4 is \$0.40; hence cost plus expense plus profit equals \$5.40, which therefore becomes the selling price. Manifestly this is wrong, since both expense and profit

are here figured on *cost* price, instead of on *selling* price. The merchant who prices his goods according to that formula, instead of making a profit of 10 per cent is actually losing money on every sale, as will be readily seen from the following simple algebraic equation, in which  $X$  is the selling price:

$$\begin{array}{rcl}
 X - 1/4X - 1/10X & = & \$4 \\
 20X - 5X - 2X & = & 80 \\
 13X & = & 80 \\
 X & = & \frac{80}{13} = 6.15
 \end{array}$$

Or, working it out arithmetically:

Selling price is		100%
Expense is	25%	
Profit is	10%	35%
Cost is		65%

Hence \$4 is 65 per cent of the selling price.  
400 divided by 65 equals \$6.15.

The right selling price, therefore, instead of being \$5.40 is actually \$6.15—a difference of 75 cents. The dealer's expense (25 per cent. of selling price) is not \$1 but \$1.54. Similarly, his profit (10 per cent of selling price) should not be 40 cents, but 61 cents. As will be seen, the wrong selling price, \$5.40, is 15 cents less than the cost of the article, plus expense of doing business. Accordingly at \$5.40 the merchant would actually lose 15 cents on every sale!

Thus it appears that the majority of failures in the ranks of retail merchants are the direct results of ignorance and lax business methods.

## REVIEW

In view of the statistics of business mortality contained in this chapter, what are your views with regard to the state of preparedness with which apparently many persons enter business; and wherein, do you think, lies the remedy for the high mortality rate revealed by Mr. Dennis' investigation?

With the importance of enterprise as an element of business success clearly in mind, endeavor to recall some business with which you are acquainted in which "dry rot" appears to be a bar to further progress. If possible, think out a plan for instilling enterprise into that business.

What, in general, should be the relation of purchases to a low rate of turnover, and why?

What should you wish to know about a retailer's collection policy, in order to consider him a safe credit risk?

Why is it of vital importance to the permanency of a business, that its accounting system records all the elements of expense that rightly enter into the conduct of the business?

## CHAPTER XIII

### CREDIT OFFICE ROUTINE

1. *Essentials of a credit system.*—The selection of a definite system for handling the work of the credit department is largely a matter of individual preference, altho in every case certain fundamental considerations must be given due recognition. Thus, the character of the business as well as its size and the many local conditions that exert an influence upon it, will in a large measure determine the various details of such a system. It is always desirable, however, that the system adopted should as far as possible automatically take care of the routine work of the department in order that the credit manager may be free to give adequate attention to matters of greater importance.

The system selected must in every case care for data of two kinds: (1) Outside information, such as agents' reports, the experience of other dealers, and so on; (2) inside information, such as is gathered from the correspondence and the ledgers, and from the records of the collection department.

Every well-organized credit office system will, moreover, provide for a close cooperation, not only with the accounting department, but with the sales and order departments. It will also, as a matter of course,

be in constant and immediate touch with the collection department.

Broadly speaking, the test of a good credit office system is that it provides, with the least delay and chance of error, the information desired, and that it guards against mistakes and omissions on the part of the credit man himself by warning him automatically of dangerous accounts and of weakening customers. It will be of interest to see how this is done in the case of an ordinary wholesale house. Tho the method described will not, of course, fit equally well every kind and condition of business, it should, nevertheless, be suggestive as to the essential points to be covered by such a system.

2. *An illustrative method.*—Usually, the credit man begins his business day by examining the contents of the morning's mail. From this source he obtains considerable information with regard to the state of collections without having to consult the ledger accounts every day. He sees, for example, what customers are taking advantage of cash discounts, and knows also at once when a draft has been returned by the bank uncollected. He also sees what new orders are received without having to wait for the reports that are sent in by the sales department and by other departments. At the same time, he is kept in touch with the latest news concerning business conditions within the trade, complaints of customers and matters of a similar nature.

In admitting a new customer to the firm's ledger,

the most important question concerns the credit standing of the newcomer. It is also important that the name and address be correctly recorded, and that a system be devised which permits all credit information relating to the new customer to be instantly available and so arranged as to serve as a guide for the credit man in passing upon subsequent orders from the same source.

3. *Requesting a signed statement.*—Frequently the information obtainable from outside sources is so meager as to be wholly inadequate for the purpose of granting credit. Frequently, too, the information at hand is too old to assure us that it accurately represents the credit-seeker's condition at the present moment. Under such circumstances, it may be deemed necessary to obtain a signed financial statement from the credit-seeker before the credit department can check the order. It is important, of course, that a request of this nature be made as tactfully as possible, lest it should offend the recipient and cause the loss of a profitable customer.

If, on receipt of such a letter, the customer ignores the request for a financial statement it is safe to assume that he has ample reason for withholding the information. Very likely he has something to conceal. It is safer, under the circumstances, that his trade be permitted to go elsewhere. If he sends a statement, the credit man proceeds to analyze it, and bases his judgment upon such statement either with or without corroborative information.

4. *Obtaining advance information.*—Obviously, the duty as well as the aim of a good credit man is to extend to customers the greatest amount of credit warranted by their condition. Accordingly, it is important that the house, whenever possible, should obtain early, as well as full, credit information about its customers. To this end, the credit man in addition to keeping in close touch with the status of those who already are customers of his house, frequently endeavors to supply himself in advance with information relating to the condition of merchants whom he regards as prospective customers. In such cases the salesmen are instructed to furnish reports upon the merchants in their territory to whom they have not yet sold goods. The credit man in the home office will meanwhile supplement such information with what he is able to obtain thru the regular credit agency channels.

5. *Forms to be filled out by salesmen.*—It is always desirable that the salesman furnish a report upon every new customer to whom he sells a bill of goods. For this purpose a form similar to that which was shown on page 86 is usually employed. This report which may be called "Salesman's New Customer Report," is attached to the order and sent with it to the home office. One advantage in the use of such a report is that it teaches the salesman to observe the characteristics of a good credit risk, and compels him to consider the probable paying ability of each new customer. Not infrequently such a re-

port is found to be so complete and satisfactory that the credit man can check the order without having to wait for further information.

In some cases, especially where the customer is located in a distant territory, the salesman, on taking a first order, fills out and sends to the mercantile agency a "Direct Inquiry Ticket"—a form which the mercantile agencies supply for that purpose, and by means of which the agency's report generally reaches the credit man's hands almost as soon as the salesman's order reaches the sales department.

6. *Handling new orders.*—On the arrival of a new order, the mercantile agency's rating book is first consulted in order that the rating given may be noted and the spelling of the name, the address, etc., verified.

The next step is to make out a triplicate "Notice of New Customer." These notices are padded successively in white, pink and yellow, or in any other three colors selected. They are worded exactly alike.

#### NOTICE OF NEW CUSTOMER

	Business .....
Name .....	
Town .....	State.....
R. F. D. ....	Ship'g point.....
Rating: Dun .....	Brad.....
Remarks .....	
.....	
.....	
Limit \$.....	(Sign.) .....
....., 19..	Credit Manager.

One sheet goes to the sales department, and shows at once that the order is from a new customer. If sufficient credit data are at hand the credit limit may already have been fixed, and will in that case appear on the sheet in the place provided for it. Where the credit limit is missing, it shows that an investigation of the risk is still being made. The information contained on this sheet is used by the sales department as a means of classifying the customer, and affords at the same time a basis for a letter acknowledging the order, or for whatever other correspondence may be called for.

The second sheet goes to the bookkeeping department. Its receipt is a warrant for the bookkeeper to open an account with the dealer named thereon. No new account is opened without authority from the credit department.

The third sheet remains in the credit department until the investigation is complete. Whatever additional information may be obtained is attached to this sheet, and the final limit is indicated. Thereupon the credit man's signature is affixed, after which the papers go to the bookkeeping department, where these later data are duly noted.

7. *Holding the order pending investigation.*—In case an order must be held for lack of sufficient credit information, the carbon duplicate, before going to the sales department, is usually rubber-stamped "New—Held for Credit." At the same time a notice is sent to the salesman informing him that an investigation

of the customer is pending. This is done so that the salesman may be kept in touch with the progress of the order. When the information is complete and the credit limit is fixed, the salesman is again notified, in order that he may have opportunity to comment on the credit man's decision if he considers such decision unjust to his customer.

8. *Final disposition of the order.*—The credit investigation now being completed, and all data desired by the bookkeeping department being duly entered upon the ledger account, the credit information is filed under whatever system of filing is used. For convenience sake, and as a check upon the correctness of the address, etc., an index card is made out. With a file of these cards at hand, the credit man is always in immediate possession of the salient points touching his customers. All further information relating to the present status of their accounts is, of course, readily obtained from the bookkeeping department.

When the card ledger system is used, an additional column may be provided to show the present balance, thus indicating at a glance the condition of the account. Places are also provided for the ratings and for the credit terms as well as for the data abstracted from the various credit sources that may have been used, covering the customer's character, capacity and capital. From time to time, this brief is revised or enlarged as new information comes to hand.

9. *Color keys in credit records.*—Some firms use differently colored cards, so that at a glance some in-

formation of vital and constant importance may be conveyed to the credit man. If the regular ledger cards are white, two other colors may be used to indicate special conditions. A blue card, for instance, replacing the white, tho containing exactly the same information, may be made to indicate that for some reason credit was at one time refused that customer. This blue card is never again changed to white. Either a white or a blue card may, perhaps, be replaced by a red. The latter may be used to show that the customer's account has been placed in the hands of an attorney for collection. The color of the card is never changed back to white, even tho satisfactory business relations with the formerly delinquent customer may have been restored. The red card stands as a perpetual warning to the credit department that at one time a serious weakness was displayed by that customer.

10. *Abstract of financial statement.*—At times it is desirable to have in condensed and convenient form an abstract of a customer's latest financial statement, including agency ratings and other essential information. For this purpose, a specially ruled card, size five by eight, is generally found most suitable. On this may be shown the quick assets singly and in total, as well as the liabilities that represent creditors' claims as distinct from capital and surplus. The excess of quick assets over liabilities may also be shown. A glance at such a statement tells the credit man what

assets may be realized in case the debtor should be forced into liquidation.

It is not, of course, material that any certain form or forms should be copied, since every credit man ought to be able to devise such forms as will best supply the need of his department.

#### REVIEW

If you were planning a routine system for a credit office, what features of such a system would you regard as especially important?

How would you proceed in handling an order from a new customer before checking prior to its being filled?

## CHAPTER XIV

### CREDIT PROTECTION

1. *Efforts to secure protection.*—It may be said of all credit information, both that which is furnished by the mercantile agencies and that which is obtained from other sources, that its chief purpose is to afford protection against losses from misplaced credits. As a means of protection, information of this kind is most commonly relied upon and is also in readily available form.

Various means have been devised for the purpose of augmenting the protection thus offered. Some of these means are legal measures, devised with a view to repossessing the owner whenever it becomes evident that his goods have fallen into the hands of persons who are either unable or unwilling to pay for them. Others seek protection thru the principle of insurance. We shall here consider the latter.

2. *Credit insurance.*—Considering the peculiar nature of credit, it is not surprising that the principle of insurance should have been applied to such transactions. The credit indemnity companies claim to supplement the commercial agencies in two respects: (1) by providing against incalculable losses thru the

application of the theory of averages to the field of credit extension; (2) by aiding the credit-giver with such information as comes from the close investigation of the creditors' own business, made necessary by the requirements of the insurance company.

The insurance company makes an investigation of the wholesaler's books in order to ascertain the average credit loss for the past five years. This first or "average" loss must in every case be borne by the insured. The indemnity company regards this loss as within the realms of certainty, and insists that inasmuch as the province of insurance is to deal with uncertainties, the initial or average loss cannot properly be a subject of insurance. Only such losses as are in excess of the initial loss are insurable. Under the terms of the insurance bond, the wholesaler is required to sell only to those retailers whose commercial rating is above a certain grade, the premiums charged being governed largely by the grade of rating allowed. The amount of credit that can be granted to any one customer is made to depend, under the regulations imposed by the credit insurance company, upon the terms of the policy and upon the customer's commercial rating.

For the purpose of illustration, let us assume that a certain wholesale firm has gross sales of \$100,000 a year, and that the average annual loss, based upon figures covering a period of five years, is \$1,000, or 1 per cent. The amount of insurance allowed to this firm may be represented by a bond for, say, \$2,500 on

which there is an annual premium of \$125, or five per cent of the amount of the bond. In accordance with the terms of the policy, all losses up to and including \$1,000 must in this case be borne by the wholesale firm. This amount is the "initial" loss. Only on subsequent losses—that is, losses between \$1,000 and \$2,500—will the insurance be operative.

Losses sustained as a result of the failure of "rated" customers—those having a capital and credit rating of a certain grade—are covered by the full amounts, or perhaps by an agreed percentage thereof; while losses of the "off-rated"—those with poor rating or with none—are never covered for more than a part of the loss.

The credit insurance company invariably investigates the character of the commercial house to be insured. It considers the line of business in which the applicant is engaged, the class of customers with whom he deals, and finally the business policy pursued by the applicant himself. The basis for determining the amount of the initial loss, the percentage and fixed limit of indemnification and the premium per year, is disclosed by the insured's own books, which tell what class of customers he has, as well as the volume of business, the size of the accounts carried, the terms of sale, the amount of collections, and the general credit policy of the house.

8. *Arguments in favor of credit insurance.*—According to the credit insurance companies, such insurance:

protects you from losses occasioned by your errors in judgment in extending credit; from losses occasioned thru erroneous mercantile credit ratings furnished you; from your inability to collect what is rightfully yours because of the insolvency of your debtor, due to floods, crop losses, wars, strikes, fires, and other unexpected and uncontrollable causes.

It is further claimed that credit insurance gives the business man control of his costs. Since he knows in advance what costs are due to bad debts, he can enter his insurance premium upon his books at once instead of waiting until the end of the year. By adding this amount to his other fixed expenses, the exact cost of doing business is easily ascertained. Accordingly, he can compute his profits with certainty. His mind is thus free to apply itself more fully and profitably to the productive part of his business. It is possible to increase sales to the maximum amount and still keep losses at a minimum.

As by the terms of the indemnity bond he is offered protection only within certain restrictions, the credit man learns to watch his customers' accounts more carefully in order that he may obtain lower insurance rates the following year as the result of a reduction of his average loss.

It is also claimed that credit insurance tends to promote trade and to prevent panics, since the confidence which it begets makes business men more aggressive and enterprising.

4. *Arguments against credit insurance.*—Business men, however, are not all convinced that the claims

made for credit insurance as a "paying" innovation in the conduct of business have been realized. Many business men ask whether it is not a fact that the normal loss—which they in every instance must bear, and which represents the aggregate of all credit losses during a number of consecutive years—includes the very risks that the indemnity company offers to insure.

This argument appears to be well founded, especially when we consider that in the nature of things every credit loss is abnormal. The normal course of every credit transaction is its ultimate liquidation by payment at the expiration of the credit period. But since experience proves that in practically every wholesale business some accounts remain unpaid, and that the amount of losses thus incurred are about the same from year to year and represent a certain percentage of gross sales, the wholesaler is in the habit of offsetting this loss by adding his loss percentage to the selling price of his goods. He protects himself in this way against diminished profits caused by bad debts. But having done this, he is likely to regard any premium which he is asked to pay for "losses" above this amount, as an added expense for which he receives no adequate return. He knows that even tho in some one year his losses should slightly exceed this normal amount, it is extremely improbable that the average losses of the next five or ten years would be higher.

Nor does it appear, as some seem to think, that credit insurance permits less vigilance on the part of

the credit man, since by the terms of such insurance he is compelled to watch his accounts even more closely than before, lest by a violation of the insurance company's stipulations he should forfeit his right to indemnity when a loss occurs.

That credit insurance, even if it were more commonly used than at present, should be able to exert any appreciable influence upon the causes that produce a financial panic, is, to say the least, doubtful. We have seen in an earlier chapter of this volume that panics are commonly brought on by an over-extension of credit. The remedy lies therefore plainly in the direction of conservative credit management and is not found elsewhere.

5. *The National Association of Credit Men.*—Among the factors that cooperate in promoting sound, efficient and honorable principles in the conduct of American business, particularly in the department of credit, a prominent place must in fairness be accorded the National Association of Credit Men. Organized in 1896 at Toledo, Ohio, this association was a direct outcome of the deliberations held at the World's Mercantile Congress, conducted under the auspices of the Chicago World's Fair in June, 1893.

Prior to that date certain associations of a somewhat similar nature had already come into existence. These, however, were chiefly credit companies or bureaus organized for the exchange of credit information. Their operations were therefore necessarily limited in scope; nevertheless, they formed the nucleus

of the national organization with which subsequently they became identified.

The object for which the National Association of Credit Men stands has been summed up as follows:

1. The organization of individual credit men and of associations of credit men into one central body.
2. A more uniform and firmer basis for granting credit in every branch of commercial enterprise.
3. Reforms in the laws that are unfavorable to honest debtors and creditors.
4. Adoption of new laws beneficial to commerce.
5. Improvement in the methods of gathering and disseminating credit information.
6. Amending business customs for the benefit of all commercial interests.
7. Providing a fund for the protection of members against injustice and fraud.

These objects have been pursued with much zeal. Considerable success has attended the association's effort to spread information relating to sound credit practice. Both in its defense of the Nation Bankruptcy Law against the attacks of those who have sought its overthrow, and in its successful efforts toward obtaining constructive legislation—state and national—the association has proved its worth to the American business world.

The membership of the association has increased rapidly until, today, the growing influence of its work is felt thruout the land. Some of the local branches have a membership of more than one thousand.

At the annual meetings of the association, subjects

pertaining to the education of business men, not only in the department of credit but also in other branches of commercial activity, are freely discussed. As an educational center for credit men, the association is doing good work, not only by means of liberal distribution of instructive literature, but—and especially—by its efforts to establish, under the direction of capable instructors, classes for the study of sound credit principles and approved credit practice.

In keeping with its avowed purpose to seek the enactment of laws favorable to honest debtors and creditors, the association has taken an active part in the promotion and defense of national bankruptcy legislation. Tho not universally indorsed—in fact actively opposed by some—the National Bankruptcy Act appears after all, to be one of decided advantage to American business.

Also in other legislative efforts has the National Association taken a leading part. Thus in promoting the enactment of bulk sales laws in the various states, the association has done valuable service in the protection of creditors against fraudulent debtors. The modification of unfair exemption laws and the vigorous prosecution of commercial fraud are among the objects actively sought by the association.

6. *Association ethics.*—Among the “canons” of commercial ethics adopted by the National Association of Credit Men are the following, which sufficiently indicate the high moral and altruistic plane upon which the association conducts its work:

In times of trouble the unfortunate business man has a right to appeal to his fellow business-men for advice and assistance. Selfish interest must be subordinated in such a case, and all must cooperate to help. If the debtor's assets are to be administered, all creditors must join in co-operating. To fail in such a case is to fall below the best standards of commercial and association ethics.

Terms of sale as a part of a contract touching both net and discount maturity, are for buyer and seller alike binding and mutual, unless modified by previous or concurrent mutual agreement. No business gentleman may, in the performance of his contracts, seek small or petty advantages or throw the burden of a mistake in judgment upon another, but must keep his word as good as his bond, and when entering into a contract of sale, faithfully observe the terms and thus redeem the assumed promise.

7. *Adjustment bureaus.*—A considerable share of the association's activities has been given in late years to the organization and operation of adjustment bureaus among the local associations, the object being to use the forces of the Association in the interest of a conservation of the assets of insolvent merchants and the prevention of bankruptcy proceedings. That for lack of proper and friendly supervision many a business failure has been precipitated is beyond dispute, just as for the same reason many a bankrupt's estate has been so loaded with settlement expenses that but little of it remained for distribution among the creditors.

Inexperience or some untoward circumstances may easily bring about an involved condition in the affairs of a dealer whose motives and intentions are of the very best. If he is thrown into bankruptcy thru the

inconsiderate course of some creditor, his business life is usually wiped out along with his business. The loss to creditors is therefore not only that which they sustain directly thru a partial loss of their accounts, but also that which comes indirectly thru the loss of his future business. With the exercise of proper care, not only might the accounts in such a case ultimately be paid in full, but the delinquent himself would be able to continue in business and remain a customer of the creditor-houses.

The local bureau of the Association, will, upon request, investigate the affairs of any debtor reported to be insolvent or financially embarrassed, and will thereafter take such steps for the protection of creditors as may be required by the circumstances. The bureau is prepared to act as assignee, trustee, or receiver in bankruptcy whenever called upon to do so.

It should be remembered, of course, that similar services are rendered by many trade associations and by credit bureaus other than those of the National Association of Credit Men. The trend of modern credit management is noticeably toward protection of the debtor's assets, and preservation of his business' existence. The fact that adjustment bureaus, conducted by local branches of the association are found in more than sixty cities, is proof of the popularity of this service among members of the Association and others.

8. *Means of recovery.*—Since the object of sales is profit, the seller is necessarily anxious to have each

sale go thru in order that the profit may be realized. There are times, however, when it is prudent to abandon hopes of profits and to take account of the means available for preventing losses. In other words there are times when remedies that have to do with salvaging the goods after a contract of sale has been made, viz., foreclosure of the unpaid seller's lien, *stoppage in transitu*, and recovery of goods transferred under a fraudulent contract, must be resorted to.

9. *Unpaid seller's lien*.—An unpaid seller who actually has possession of the goods may in any one of the three following cases, retain possession of them till he is offered payment: (1) when no credit was anticipated by the contract; (2) when the term of credit has expired; (3) when the buyer becomes insolvent.

10. *Stoppage in transitu*.—Even if the seller no longer has possession, he may protect himself against an insolvent purchaser by resorting to the remedy known in law as *stoppage in transitu*. But to avail himself of this relief he will have to act quickly. If he can get notice to whoever is in charge of the goods while they are in transit, i.e., before they get into the possession of the buyer, that person will be bound to return the goods to the seller, who will then have the same rights in them as if he had never parted with their possession.

Nice questions frequently arise as to whether the good are still *in transitu*. Goods are still in transit while they are in the hands of the carrier. The right

of *stoppage in transitu* is lost in any one of the following cases, because the goods are no longer technically in transit: if the buyer or his agent gets possession before the goods arrive at their destination; or if, having arrived, the goods are confessedly held by the carrier as the bailee of the buyer; or, if having arrived, they are wrongfully withheld from the buyer.

When the carrier is properly notified, he must re-deliver the goods to the seller, upon whom falls the burden of expense. Moreover, if a negotiable document of title, i.e., a bill of lading, has been issued by the carrier, the goods should be withheld by the carrier till this instrument has been surrendered for cancellation.

The right of stoppage is open to the seller only after the buyer has become insolvent. The Uniform Sales Act which has been adopted in a number of states reads, in part, as follows:

A person is insolvent within the meaning of this Act who either has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of bankruptcy or not, and whether he is insolvent within the meaning of the federal bankruptcy law or not.

There is no Uniform Sales Act in Canada, but the general rule may be laid down that if, after shipping the goods, the seller finds that the purchaser has become insolvent or is on the eve of insolvency, he may stop the goods in transit. A person who has ceased to pay his debts in the ordinary course or who cannot

pay his debts as they become due, would be deemed to be on the eve of insolvency.

11. *Reselling the goods.*—Suppose the seller actually has possession of the goods now, either because he has exercised his primary lien, or because he has recovered them thru his right of stoppage. What may he do with them? He may resell them. If they are perishable, he does this immediately; if they are not perishable, he waits a reasonable time for the buyer to pay the price. If the goods are not perishable, the seller will act wisely if he notifies the buyer of his intention to resell the goods. This notice is not absolutely indispensable, but it establishes the seller's good faith in the transaction. If the seller makes an extra profit in the resale, he is entitled to retain it, but if he suffers any loss, he may hold the original buyer in damages.

12. *Recovery on the ground of fraud.*—If neither of the two remedies just described is available, one more is left. The seller may be able to have the entire transaction set aside as fraudulent. It must be remembered, however, that lawyers realize that it is always difficult to prove fraud. The mere fact that the buyer is insolvent is not proof that he has practised fraud. But if a buyer has relied on a fraudulent financial statement, the buyer may be able to prove the case against him. Then, too, it must be remembered that even tho the buyer is guilty of fraud, he actually obtains title, and that this may be transferred to an innocent purchaser. In discriminating between

the latter and the original seller, the courts favor the innocent purchaser, since he could not be justly blamed for his part in the fraudulent transaction.

13. *Steps in litigation.*—Let us suppose that the creditor has no opportunity to recover the goods, or that if he has, he does not think it wise to make use of the opportunity. What procedure is necessary to obtain the redress provided by law? Since we are interested here only in the purely legal phases of collection, we shall say nothing about the work of the attorney as a collector. That phase of the subject has been treated elsewhere.

Generally the law does not give the creditor full recognition as creditor till his status has been established in a court of law. In order to get the debtor into court, it is necessary to serve him with a summons. Then, that the time of the court may not be wasted, the parties state, in documents known as pleadings, what they expect to prove. At the proper time a trial is held, the evidence is submitted to sustain the allegations made in the pleadings, and a judgment is issued either for the plaintiff or for the defendant. If the latter wins the case, the complaint is dismissed and a money judgment is entered against the plaintiff for costs. Frequently the debtor has no defense, and merely defaults. If this is the outcome, a judgment is entered against him without a trial of the case. It must be understood that this summary is only the barest outline of judicial proceedings in an ordinary

action to collect a debt. The details are technical in a high degree, and are therefore usually left entirely in the lawyer's hands.

14. *Importance of evidence.*—While the court will consider any statement that savors of the truth, it places strong emphasis upon the importance of evidence. A person may be absolutely certain that he has a meritorious case, yet if he cannot bring forward evidence, his suit will be dismissed. The motto of Cromwell and his soldiers, "Trust in God, and keep your powder dry," expressed no less faith because of its implication that man must do his part. And similarly, we show no lack of confidence in those who administer justice, tho we say, "Trust in the courts, and be sure to give them a good case."

Lawyers must depend on their clients for the facts. While some concerns are very successful in their collection cases, other houses are not nearly so successful. Cases are lost because delivery slips have been mislaid, or because signatures or order forms cannot be proven. While on the one hand, it is unwise to arouse a customer's suspicions by checking his account too critically, certainly on the other hand, it is merely ordinary business prudence to remember that at any time a debt may have to be established in a law court by sufficient competent evidence, and to conduct the account accordingly.

15. *Enforcing the judgment.*—A judgment is no better than the judgment debtor. One cannot squeeze

water out of a stone, nor can one get money out of a pauper. There are some debtors, however, who can pay their judgment, but will not. To gain access to the property of unwilling debtors is not the least important part of the collection process. After the judgment is docketed, an execution is delivered to the sheriff or to some other executive officer of the county or city, who is thereupon directed to make a levy on the goods of the debtor. If the levy is made, in due course the goods are sold at public auction and the judgment is satisfied out of the proceeds. If no goods are found, the execution is "returned unsatisfied." The completion of this process paves the way for the other remedies provided by law.

16. *Exemptions.*—One purpose of the law is to prevent people from being reduced to poverty. In such a condition they would be a charge to the community. Hence laws have been passed which exempt certain property from seizure to satisfy debts. Usually such exemption applies to a small homestead, necessary clothing and home utensils, certain domestic animals and a low income.<sup>1</sup>

17. *Supplementary proceedings.*—When a judgment is returned wholly or partly unsatisfied, the creditor has the right to discover concealed property.

<sup>1</sup> Digests of exemption laws may be obtained and should be at hand for instant reference. A good collection of such laws, as well as of other statutes enacted by the legislatures of the various states, is that contained in Martindale's "American Law Directory" (New York). That volume presents a large amount of legal information that is of interest in all credit matters.

Generally it is useless for him to begin these proceedings unless he has some grounds for believing that property has been sequestered. But if this has been done, a clever examiner can usually prove the fraudulent concealment and can ferret out the property by means of a vigorous examination.

18. *Setting aside fraudulent conveyances.*—It may happen that the debtor has actually parted with title to his property, altho the transfer was made without adequate consideration and was effected for the purpose of preventing creditors from collecting their debts. The facts in such a situation are frequently brought out in supplementary proceedings, and are then made the basis for a so-called judgment creditor's action, the purpose of which is to set aside the illegal transfer. If this is accomplished, the goods can be taken in satisfaction of the judgment and of the costs of the various legal proceedings.

The burden of proving fraud is on the creditor, and difficulties that tend to prevent proof always present themselves. The vigilant creditor will anticipate these difficulties by a little detective work in season, and the credit man who "has a nose" for fraud and who can present to his lawyer concrete evidences of underhand work on the part of the debtor, is a valuable factor in the recovery.

19. *Bulk Sales Law.*—In cases of litigation the burden ordinarily rests on the creditor to prove that the debtor is guilty of making a fraudulent transfer, but according to modern statutes conditions are re-

versed if the debtor transfers his goods in bulk—i.e., not in the ordinary course of trade.

20. *Receivers.*—When there is question about the ownership of property, and there is danger that some person who may have a rightful claim upon it will suffer if the present owner continues in possession, a court will appoint a receiver to take charge of the property till all claims can be determined judicially. Suppose, for example, that the debtor has title to an apartment house that is heavily mortgaged. The debtor may be collecting the rents and squandering them, instead of paying the taxes and the mortgage interest, thus courting foreclosure instead of protecting his equity for the benefit of his creditors. These facts would move an equity court to take over the property thru the instrumentality of a receiver. In the Province of Quebec a sequestrator would be appointed by the Court upon petition.

21. *Garnishment.*—The term garnishment applies to the legal process whereby property which belongs to a debtor, but which is in the hands of a third party, may be reached to satisfy the debtor's debts. By means of this process all forms of property may be reached, including even a part of the debtor's salary. Garnishment proceedings are generally governed by the statutes of the several states or provinces which must be consulted in order to find out how and to what extent each jurisdiction permits the use of this form of securing payment.

22. *Attachment.*—It has already been stated that the procuring of a judgment is merely one of the steps in the legal collection of a debt. Even when a suit is diligently prosecuted, from the serving of a summons to the entering of a judgment, so much time may elapse that a fraudulent debtor may have ample opportunity to make himself “judgment-proof” by moving his property to another jurisdiction or by giving it away. The law provides the creditor with a so-called provisional remedy against this practice. The creditor may begin his action by attaching the debtor’s property. In this case affidavits are submitted to the court which, on being satisfied that there is ground for applying the remedy, will order that the property of the debtor be seized and held before judgment. If after that the creditor gets a judgment, he is immediately in a position to satisfy it. If, however, he fails to get a judgment, the property is released and the plaintiff is bound to pay all the costs and damages. To guarantee payment he is required to put up a bond when the attachment proceedings are instituted. Since the costs and damages are relatively heavy, attachment proceedings must be very carefully begun and as carefully prosecuted. Any of the following conditions generally constitute grounds for an attachment: (1) if the defendant is a foreign corporation or a non-resident individual; (2) if the defendant has evaded the service of the summons; (3) if he has concealed himself; (4) if he has disposed of his property with intent to defraud creditors; (5) if he has made a

false statement in writing regarding his financial responsibility.

Attachment is generally regarded as an extreme remedy—one not to be resorted to without first securing competent legal advice. Sometimes instead of actually seizing the property it may be better to obtain an injunction forbidding the debtor to dispose of it. If this method is adopted and the plaintiff subsequently fails to get a judgment, the damages he would have to pay the defendant would not be so heavy as if he had seized the defendant's property and then failed to win the case.

23. *Imprisonment for debt.*—Altho imprisonment as a punishment for debt is today seldom resorted to, the debtor may, in some cases involving moral turpitude, be imprisoned if his judgment debt is not paid. Generally the summons or pleadings must contain some notice that the plaintiff intends to have the debtor imprisoned if the latter loses the case and still refuses to pay what he owes. This provision gives the debtor opportunity to defend an action which otherwise he might permit to go by default. Such procedure is generally allowed when the debtor has been guilty of fraud in incurring the liability, or has fraudulently disposed of his property. Since this remedy, like garnishment, is statutory, the method of using it and the extent to which it may be used varies in different states and provinces.

24. *The criminal law as a remedy.*—It is a general principle of law that creditors may not use the crim-

inal courts as collection agencies. And this, notwithstanding the fact that there have been many instances in which a fraudulent debtor has been as much a menace to society as a common thief. Indeed the individual can protect himself against the thief by means of lock and key, but he is the cheat. The law is in the latter case the sole defense. Recognizing these facts, state legislatures have recently enacted laws making it a crime for any person to obtain credit by means of a false financial statement. In Canada, under the Criminal Code, a Dominion Statute, it is a crime to induce a person, by a false pretense or representation made with fraudulent intent, to act upon such representation, as, for instance, to part with goods. While the punishment of the delinquent may in no wise help the defrauded creditor, the demands made by society upon the credit man should be sufficiently strong to urge him to aid in carrying out the provisions of the criminal law.

25. *Shall we go to law?*—An eminent English lawyer, Mr. Maryatt, King's counsel, once expressed the following opinion in regard to lawsuits:

If any man were to claim the coat upon my back, and threaten my refusal with a law suit, he should certainly have it; lest in defending my coat, I should find that I was deprived of my waistcoat also.

Bouvier, the eminent legal lexicographer, defines a good lawyer as one who, among other things, 'is disposed to avoid litigation.' Certainly litigation is frequently fruitless and is always expensive. A good

credit man will seek to avoid being caught in bankruptcies and will as far as possible keep his concern from the need for litigation by guarding well against improper credit extensions. But if it appears necessary to resort to the courts, he will first ask, "If I do get a judgment can I collect it?" Then he will remember that to get his judgment and to collect it he will need "a good cause, a good purse, a good counsel, a good judge, a good jury and good luck."

#### REVIEW

Examine the claims made for credit insurance, and formulate answers to meet these claims if they appear to you as not well sustained.

What considerations lead you to commend the work of the adjustment bureaus?

When may a shipper exercise the right of stoppage *in transitu*, and when is he debarred from exercising that right?

How are goods recovered when there has been misrepresentation or fraud?

## CHAPTER XV

### BANKRUPTCY

1. *Meaning of bankruptcy.*—In ancient Rome, when a money-changer became insolvent, he was put out of business by his associates who broke the bench upon which he kept his stacks of coin. Some people believe that this rupture of the bench or bank is the explanation of the derivation of the word bankrupt. Certainly the process indicates very nearly what happens today. A man is insolvent; then the condition is proclaimed, not, to be sure, by the breaking of a bench, but by the signing of a decree of bankruptcy by a competent court.

Bankruptcy, then, may be defined as a process pursuant to some statute whereby an insolvent is declared a bankrupt, his property taken and equitably distributed among his creditors, after which he is discharged from further liability. Under the older bankruptcy acts of Anglo-Saxon jurisprudence, the object was to get the insolvent's property, but the later legislation recognizes the importance of the discharge from liability as a means of renewing the economic vitality and effectiveness of an unfortunate debtor.

2. *Meaning of insolvency.*—The law recognizes two definitions of insolvency. When a man has plenty

of unliquid assets—a person is said to be land-poor for example,—and cannot pay his debts as they mature in the ordinary course of business, he is said to be insolvent. He may have plenty of wealth; what he needs is time to get it into the proper form to use it for discharging his obligations. If his creditors try to force the process of conversion by getting judgments, seizing parts of the property and offering them at forced sale, the value of the property, disrupted and deprived of the opportunities of fair bargaining, may shrink to an amount actually less than the aggregate of the indebtedness. The appointment of a receiver will prevent this helter-skelter seizure of property, and time may be obtained to make a reasonable sale. Frequently, when the true condition of the debtor is understood some arrangement will be made to give him a reasonable extension. Receiverships are thus a very important aid in the work of the credit man.

Another definition of insolvency contemplates a debtor whose assets are, at a fair valuation, less than his liabilities. It is this definition that is recognized by the bankruptcy law, which provides that the prerequisite of bankruptcy must be insolvency.

3. *Bankruptcy and insolvency laws.*—At one time in England the difference between bankruptcy and insolvency was quite different from what is indicated in the preceding section. In those days only traders became bankrupts. Gentlemen of leisure became insolvents, and since trading was regarded as

unrefined, and "tradesman" was a word which when applied to a person of gentle birth lowered his social rank, to call a nobleman a bankrupt was sufficient cause for a slander suit.

The distinction between insolvency laws and bankruptcy laws today does not rest on these considerations. Technically there is no difference between these laws, but by general custom the words "bankruptcy law" in this country are reserved for the federal act and the words "insolvency laws" are generally applied to the state acts.

4. *State and federal laws.*—Congress is given power to pass uniform bankruptcy laws for all states. If Congress does not exercise that power the states may have their own insolvency acts. Thus we find on the statute books of almost every state a bankruptcy law that is inoperative because the federal bankruptcy act has superseded it. But the operation of the state laws is simply held in suspense, for if Congress should repeal the federal act, as has been done on several occasions, the state acts would immediately spring into force.

The present bankruptcy act dates from 1898, amendments having been made in 1903 and 1910.

5. *Two kinds of bankruptcy.*—Under this act, the proceedings which result in the decree of bankruptcy, are begun by filing a petition. This petition is a written document alleging the essential facts necessary to warrant the court in adjudicating the insolvent person a bankrupt under the terms of the statute.

If the petition is signed by the debtor himself, and proceedings are thus begun by him, the bankruptcy is said to be voluntary. In such a case the main object proposed is the final discharge of the debtors from liability. If, on the other hand, the petition is signed by creditors, the proceedings are called involuntary and the main object is to get the bankrupt's assets and to apply them ratably to the payment of his debts. Thereafter the bankrupt may apply for his discharge just as he would in voluntary bankruptcy.

6. *Contents of the petition.*—Petitions may be filed against any person who might seek voluntary bankruptcy, with the exception of farmers or tillers of soil and wage earners earning less than \$1500 a year.

Besides showing that the alleged bankrupt is a person capable of being declared a bankrupt, and is insolvent, the petition must show that the debtor owes at least \$1000 in the aggregate. If the proceedings are involuntary the petition will have to be signed by three creditors whose aggregate claims amount to at least \$500, or by one creditor with a \$500 claim if the total number of creditors, excluding certain near relations, are less than twelve. Moreover, it is necessary to allege in involuntary proceedings that the debtor has committed a so-called act of bankruptcy.

7. *Acts of bankruptcy.*—The fact that a person happens to be insolvent is not sufficient reason for setting the machinery of the bankruptcy courts in motion. These courts exist for the purpose of protecting creditors and helping insolvent debtors to gain a

new lease on life. If the latter object alone is to be attained let the debtor begin his voluntary proceedings. But until the creditors' rights are jeopardized the courts need not interfere on the ground of protecting the creditors' claims.

The bankruptcy act, therefore, enumerates five acts which, when coupled with insolvency, are grounds for believing that the rights of the creditors as a class are in danger. When the creditors can prove that one of these acts has occurred, the insolvent debtor will be declared a bankrupt.

8. *The five acts of bankruptcy.*—The acts of bankruptcy enumerated by the statute are as follows:

(1) Transferring or concealing property with the intent to defraud or hinder creditors.

(2) Granting preferences. If a debtor pays an antecedent debt due to one creditor he thereby diminishes his estate applicable to the payment of his other debts.

(3) Preferences permitted by legal proceedings. When a creditor gets a judgment, he is entitled to seizure of such a part of the debtor's estate as will satisfy the judgment. If the execution sale actually takes place it will have the same disastrous effect on other creditors as a voluntary payment. Hence unless the proceedings are vacated within five days of the date advertised for the sale, the debtor will be deemed to have committed an act of bankruptcy.

(4) An assignment for the benefit of creditors or the appointment of a receiver is ground for an appli-

cation to the bankruptcy courts. This explains, no doubt, why assignments generally are not made. They simply invite bankruptcy proceedings; why not, therefore, begin the proceedings at once?

(5) Written admission of insolvency and willingness to be declared a bankrupt is the fifth ground. Before 1910, it was frequently used by insolvent corporations, because prior to an amendment of that year corporations could not become voluntary bankrupts.

Any one of these acts, committed while the debtor is insolvent, and within four months of the filing of the petition, is sufficient to move the court to sign the decree.

9. *Provisional remedies pending adjudication.*—Suppose an involuntary petition has been filed. The facts stated in it may be denied by the alleged bankrupt. He has at least five days in which to answer. That time will give a dishonest debtor ample opportunity to lay up stores against the time when he will emerge from the period of bankruptcy by an unmerited discharge. But the law is adequate to meet the situation, and a wide-awake credit man will be diligent to use every resource which the law affords.

In the first place an order may be obtained for the immediate seizure of the debtors' goods, or he may be enjoined from disposing of them. If he disobeys the injunction, he may be jailed for contempt of court. If the insolvent tries to evade bankruptcy or examination of his assets by leaving the jurisdiction of the court, application may be made for his immediate

arrest. Moreover a creditor need not wait till a debtor has been declared a bankrupt but may begin separate actions to have illegal and fraudulent transfers of property set aside. These actions will be continued afterward, virtually as a part of the bankruptcy proceedings.

The usual remedy sought by creditors is the appointment of a receiver. This officer can then proceed to reduce all property to possession and can begin to straighten things out for the trustee.

10. *Trial and reference of proceedings to referee.* After the alleged bankrupt is given a reasonable opportunity to deny that he should be declared a bankrupt, either the petition is dismissed because it has not been sustained by proof, or the decree is signed—either on account of the bankrupt's failure to answer or because the facts alleged in the petition are found to be sufficient and true. The usual course is the signing of a decree upon default.

The proceedings are then referred to a referee who really has charge of the entire matter from this time on with the exception of the confirmation of any proposed composition with creditors and the final discharge of the bankrupt. These proceedings must again come before the court. Referees are appointed by the federal court for a term of two years. They have such intimate relations with all the proceedings that the law provides for at least one referee in each county.

11. *Meetings of creditors.*—The referee attends all

examinations of the bankrupt, declares dividends, requires the filing of schedules and notifies creditors. His first act is usually to call the creditors' first meeting at which a trustee is elected by the creditors and the amount of the trustees' bond is fixed. Creditors are often of great assistance to receivers and trustees in giving suggestions, and it is important that they attend meetings. But they do not run the estate. The court always retains jurisdiction and in effect merely seeks the views of the creditors in order to come to a wise decision. Notices of meetings and other proceedings should be carefully observed and filed away for future reference.

12. *Trustees in bankruptcy.*—As soon as the creditors can get together they elect a trustee who takes the custody of the property from the bankrupt or from the receiver. The election of the trustee is usually made on the basis of two votes—one on the per-creditor basis and the other on the per-dollar-of-claims basis. If both votes result in the selection of the same candidate his election is usually approved by the referee. If there is a conflict in the results of the two votes the referee appoints a trustee—usually the person who received the largest number of per creditor votes.

Probably in most cases the selection of the trustee comes about in the following way: After the petition in bankruptcy has been filed, the attorneys for the petitioning creditors ask for a receiver. When the receiver is appointed, application for counsel for

the receiver is made and the same attorneys are retained. Subsequently the receiver is likely to be elected trustee of the estate since he has the claim of being familiar with its affairs. Then, upon application for the appointment of counsel for the trustees, the same lawyers are again retained. In this way the matter is practically always under the guidance of the lawyers of the petitioning creditors.

The trustee takes title to the bankrupt's property and does all things necessary, even to the bringing and defending of actions, to conserve the estate for the benefit of the creditors.

13. *Duties of bankrupt.*—The bankrupt is required to help in the administration of his estate, and he is a wise person who undertakes this task willingly and earnestly. The bankrupt must attend such meetings and submit to such examinations as may be deemed necessary. Indeed, the receiver and the trustee in seeking to discover all the bankrupt's property in order to reduce it to possession may examine not only the bankrupt, but his friends, family and associates. When claims are made against the estate, the trustee usually consults with the bankrupt to see if the claims are valid. Moreover, the bankrupt is required to file schedules of his assets and debts.

14. *Schedules.*—As was pointed out before, the business of bankruptcy proceedings besides discharging the bankrupt from his debts includes: The gathering up of the assets and the application of the assets to the payment of liabilities. The schedules

in bankruptcy are, therefore, an index to the entire proceedings. They list all the assets and arrange the liabilities in the order in which they will have to be paid.

In voluntary proceedings the schedules must be all ready to file with the petition. In involuntary proceedings they are filed within ten days after the decree has been signed. In either case they are filed on standard forms which can be procured at any law stationers.<sup>1</sup>

15. *Valid, provable and allowable claims.*—The difference in the words “valid,” “provable” and “allowable” as applied to claims against a bankrupt’s estate is important and should be understood at the outset. First, let it be known that allowable claims must be provable and must be proved before the question of allowance arises and that all provable claims must be valid. Therefore, there may be valid claims that are not provable and provable claims that are not allowable.

16. *Valid claims.*—A claim is valid which outside of bankruptcy proceedings is not subject to any defense that might be raised by the debtor. A valid claim must have foundation in law. Thus, for ex-

<sup>1</sup> The reader who desires to complete his information on this subject will do well to apply at the office of the clerk of a federal district court for all the papers in any bankruptcy proceeding that strikes him as being interesting. For this purpose he should first consult the bound register of proceedings and select a contested involuntary case in which a receiver has been appointed. The papers beginning with the petition and ending with the discharge can then be examined carefully and will serve to make much that is contained in this chapter concrete and to impress it on the memory.

ample, if a father is bankrupt, some person whom his minor son has injured might make a claim against the bankrupt's estate. The claim would not be valid since every infant is responsible for his own wrongs. In this case no question as to the provability of the claim would arise. The claim would be rejected immediately since it is not valid.

17. *Provable claims.*—Before claims may be allowed against the estate, they must be proved. This is done, to use the words of the Bankruptcy Act, by the creditor who fills a formal affidavit "setting forth the claim, the consideration therefor, and whether any, and if so what, securities are held therefor and whether any, and if so what, payments have been made thereon, and if the sum claimed is justly owing from the bankrupt to the creditor."

The United States Supreme Court is given power to supplement the bankruptcy law in such ways as it may deem expedient. In some of its general orders it has prescribed the form in which proof of claims shall be made. The creditor will do well to follow this form by procuring an official blank from a law stationer. When the claim is on a promissory note, the original note should be attached to the proof of claim.

Generally, tort claims such as claims for damages from negligence, slander or trespass, and contingent claims are not provable. Rent due or accrued before the petition is filed is provable; rent due after the petition is filed may not be used as a claim against the

estate unless the trustee elects to treat the lease as an asset of the estate. Claims actually arising before filing the petition, tho payable thereafter, are provable. Claims arising after the petition is filed are not provable and remain as a charge against the bankrupt after his discharge in bankruptcy.

As we shall see, bankrupts are not discharged from the burden of judgments obtained for fraud, deceit or the like, but the claims arising therefrom are provable. Unliquidated contractual debts are provable but must be liquidated before being allowed. Thus a doctor may prove his claim for services, but the amount due must be settled before the claim can be allowed.

Provable claims must be proved within one year from adjudication. The credit man as a matter of good business, should proceed immediately to file his claim as soon as he learns that the decree has been filed.

18. *Allowable claims.*—Usually before the first meeting of creditors, many proofs of claims will have been filed. If they are not in proper form or if they are in the class of unprovable claims, they will be rejected. If, however, they are provable and have been proved, the next question to decide is whether they shall be allowed. Generally all provable claims are allowable. The two important exceptions are first, secured claims which are allowable only to the extent of the difference between the amount of the claim and the value of the bankrupt's property securing.

the claim, and, second, claims with voidable preferences which will not be allowed till the preferences are surrendered.

19. *Voidable preferences.*—A preference is defined by the bankruptcy act as follows:

A person shall be deemed to have given a preference, if, being insolvent, he has, within four months before the filing of the petition or after the filing of the petition and before the adjudication, procured or suffered a judgment to be entered against himself in favor of any person, or made a transfer of any of his property, and the effect of the enforcement of such judgment or transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class. Where the preference consists in a transfer, such period of four months shall not expire until four months after the date of the recording or registering of the transfer, if by law such recording or registering is required.

We saw that a preference, within this definition, constituted an act of bankruptcy (Section 8 of this chapter). Beyond what is necessary to prove that a preference has been given constituting an act of bankruptcy it must be shown that the creditor knew or had reason to know that he was being preferred. If this can be shown, then the preference, if it conforms to all the other requirements of the above definition, will be voidable, and as we saw, the creditor will have to give up the preference if he wants to get any further benefits from the estate by having his claims allowed.

20. *Priority of debts in distribution of bankrupt's estate.*—In dividing the bankrupt's assets among

creditors certain priorities are established by the law, the order being as follows:

1. Taxes due United States government.
2. Other taxes.
3. Cost of preserving and administering the bankrupt's estate.
4. Fees paid to the court clerk by creditors and one fee for attorney of bankrupt or petitioning creditors.
5. Wages, not exceeding \$300, earned during three months prior to the filing of the petition.
6. Claims secured by valid unavoidable liens.
7. Debts given priority by United States or State laws.

The claims in each class will have to be paid in full before claims in any subsequent class can receive any payment whatever. The last class, in order to be paid, is the general unsecured claims.

21. *Dividends in bankruptcy.*—As was stated in the previous section, general creditors are entitled to no dividends whatever until the priority claims have been taken care of. If, after these have been paid, there is a surplus equal in amount to five per cent of the general claims, a dividend must be paid on them within 30 days of the adjudication of bankruptcy, and thereafter dividends must be paid whenever the realized surplus equals 10 per cent of the general claims. The law also provides that the first dividend cannot exceed 50 per cent of the general claims, that the final dividend must not be paid within three months

of the adjudication and that the dividends must not be less than two in number.

22. *Composition with creditors.*—Every credit man knows that litigation is expensive. If it becomes evident that the bankrupt is honest and that there is to be little difficulty in ascertaining the amount of his estate, it may be wise to permit him to handle his own affairs and to accept his proposal to pay so many cents on the dollar as a full discharge of his duties. In determining whether a composition shall be accepted or not, due consideration must be given to the honesty and ability of the bankrupt, to the possible value of his estate and to the number and size of the claims that will probably be presented and allowed.

A composition with creditors must always be confirmed by the court. If it has been confirmed, the bankrupt may apply for his discharge. Under the law the court cannot confirm a proposed composition unless the following conditions have been met: (1) the schedules must have been filed; (2) the bankrupt must have been examined; (3) the composition must have been accepted in writing by the majority of the creditors representing more than half the bankrupt's debts; (4) enough money must have been deposited in amount to pay (a) the composition, (b) the cost of court proceedings, (c) preferred debts in full; (5) the judge must be satisfied that the composition will best serve the interests of all the creditors; (6) it must be established that the bankrupt has not

committed fraud; (7) the composition must not be fraudulent; (8) the composition must not be for much less than the real value of the estate. When the application is being made for the confirmation of the composition, any creditor may object at the hearing and raise the objection that any one of the conditions above enumerated is lacking. After hearing all sides, the court can use its own discretion in confirming or rejecting the composition.

**23. *Discharge of bankrupt.***—As was indicated above, one of the main purposes of bankruptcy laws is to discharge the bankrupt debtor, thereby giving him a new start in life. Under the present bankruptcy act this discharge may take place any time after one month from adjudication. Application for a discharge must be made within twelve months of the adjudication of bankruptcy, but this time may be extended six months by the court. The bankrupt cannot be discharged from liability for his debts if he is guilty of fraud or has been previously discharged in bankruptcy within six years.

**24. *Debts not discharged in bankruptcy.***—The effect of a discharge generally is to cancel all liability on debts incurred before the filing of the petition. A discharge in bankruptcy, however, does not cancel the following debts:

1. Those incurred after the petition has been filed.
2. Taxes.
3. Liabilities for obtaining property under false pretenses.

4. Liabilities for wilful or malicious injury to property or persons.

5. Alimony.

6. Support of wife or child.

7. Debts not scheduled in time for proof and allowance unless it can be shown that the creditor had actual notice of proceedings.

8. Debts arising out of the bankrupt's breach of fiduciary obligations.

Liabilities falling in any one of the classes above enumerated remain a burden on the bankrupt after his discharge and the creditor will be justified in seeking to enforce the obligation by taking any proceedings he might take if the bankruptcy proceedings had never been instituted.

25. *Advantages of bankruptcy act.*—The National Credit Men's Association has done an excellent piece of work in keeping the present bankruptcy act on the statute books. This act has frequently been attacked by certain interests that would probably profit by a recurrence to the confusion in which business was steeped when the property of insolvent debtors was subject to administration under state laws. The present bankruptcy act insures fair and uniform treatment to all creditors and provides a safe method of reaching an insolvent debtor's property.

26. *Canadian Practice.*—There is no national bankruptcy or insolvency law in Canada, and there has not been since 1880. Each province has its own insolvency laws and procedure. In none of the prov-

inces is a debtor discharged by becoming an insolvency. If the dividend from his insolvent estate does not meet the claims of his creditors in full, they have their recourse for any balance so long as their claim is not outlawed. The discharge from further liability is an incident of bankruptcy legislation, and as such could only be enacted by the Dominion parliament. The general effect and purpose of the provincial insolvency laws is to secure a ratable distribution of an insolvent's estate among his creditors.

*27. Procedure.*—A trader who finds himself in difficulty may make a voluntary assignment of his estate for the benefit of his creditors. The assignment may be made to the sheriff of the county, to an official assignee, or to a resident of the Province approved by a majority of the creditors whose claims amount to \$100 or more.

In Quebec alone can a debtor who is in insolvent condition and yet refuses to assign, be forced to do so. He must either pay or be subject to civil arrest, in which case his assets are seized and dealt with for the benefit of creditors.

In the other provinces much the same practical result is secured by proceeding under the provincial Creditors' Relief Act. In the first place, if an insolvent trader refuses to assign, an action may be brought by one creditor on behalf of himself and all other creditors of the same class, and under his judgment all the assets may be sold and the proceeds ratably distributed among any executive creditors and

other creditors who prove and file their claims within the proper delays.

On the other hand, if a judicial assignment is made, then another procedure is followed. In most of the Provinces, other than the Province of Quebec, a copy of the assignment with an affidavit of a witness must be registered—generally at the office of the County Court Clerk, tho in some provinces at the office for registry of deeds. In all the Provinces the assignment must be advertised in the Official Gazette and in one or more newspapers. This notice calls the creditors to a general meeting and notifies them to prove and file their claims. Claims should be accompanied with such vouchers as the nature of the claims permits. At the general meeting a curator is appointed, and he proceeds to get in all assets, to realize on goods and property, pay privileged claims and pay a dividend to ordinary creditors.

28. *Fraudulent conveyances and transfers.*—Gifts or other gratuitous contracts made when a person is unable to pay his debts in full or knows that he is on the eve of insolvency, are deemed to be made with intent to defraud creditors, and may be set aside. That is the general rule of the English law provinces. In Quebec every conveyance or transfer of either personal or real property with the intent to delay or defraud creditors by any person who knows he is on the eve of insolvency is void against such creditors, providing the other party to the contract knows his intention and acts in collusion with him. So also a

large payment of money or a transfer of property by an insolvent to a creditor knowing his insolvency, is deemed to be made with intent to defraud, and such creditor may be compelled to make restitution or pay the value, for the benefit of all creditors concerned. And generally, where a debtor in insolvent circumstances, or on the eve of insolvency, voluntarily, or thru force, gives a confession of judgment that has the effect of defeating or defrauding his creditors, or of giving one or more a preference over others, the judgment is void and cannot be executed. So also a sale on credit to a person who knows of the vendor's insolvency is generally held as fraudulent as against creditors, in that it hinders and delays them. A chattel mortgage to secure a creditor, or in settlement of a debt previously contracted, or to secure a surety, if given within sixty days of an assignment, is void as towards other creditors. In Ontario, by an amendment passed in 1910, if an assignment is made within sixty days after a transaction that has the effect of giving one creditor a preference over others, such transaction is presumed to be performed with that intent.

29. *Fraud by insolvent traders.*—It is not deemed fraud, legally speaking, for an insolvent trader to continue to purchase goods without disclosing his true position, where no questions are asked. If questioned, he must either state the facts or refuse the information, leaving the other party free to accept the order or reject it. But if he represents that he is

solvent when he is not, in order to get goods on credit, his act is fraudulent. If the seller discovers the true facts he may refuse delivery or stop the goods in transit. He may also have the dealer arrested for giving false replies.

The effect of our statutes in their leniency is certainly to discourage a trader who is deeply involved from continuing in business, as he may manage to pull out safely. He is not bound to publish his financial difficulties to the world.

30. *Winding up of companies.*—In an earlier section it was said that in Canada there is no Dominion Bankruptcy or Insolvency Act. This statement must now be qualified in this respect, that there is a Dominion Winding-Up Act, applicable to incorporated companies. The Dominion Winding-Up Act applies to all trading companies, wherever incorporated, doing business in Canada, which are insolvent. Provincial Winding-Up Acts apply only to companies, not insolvent, which are in voluntary liquidation. Our courts are entitled to protect the rights of Canadian Creditors upon the assets of a foreign company doing business in Canada. Thus, suppose a company incorporated and having its head office in France has a branch in Montreal. If winding-up proceedings are begun against the company in France, our Courts may under our Dominion Act order it to be wound up so far as concerns its assets in Canada. If our Courts, on the other hand, order the winding-up of the Canadian end of the business, the company's opera-

tions in the foreign country of its origin are not affected unless its home creditors take similar steps.

**31. *Insolvency of a company: law determined.***—A company is deemed insolvent under the Winding-up Act:

- (a) If it is unable to pay its debts as they become due.
- (b) If it calls a meeting of its creditors for the purpose of compounding with them.
- (c) If it exhibits a statement showing its inability to pay its debts.
- (d) If it has otherwise acknowledged its insolvency.
- (e) If it assigns, removes or disposes of its property with intent to defraud, defeat or delay creditors, or if it attempts so to do.
- (f) If, with such intent, it has procured its money, goods, land or property to be seized under execution.
- (g) If it has made a general conveyance or assignment of its property for the benefit of creditors, or if without their knowledge and against their interests it sells or conveys the whole or the main part of its assets.
- (h) If it permits any execution issued against it to remain unsatisfied for fifteen days, or to within four days of the date of sale.

A company is deemed to be unable to pay its debts as they become due, and to be insolvent, when a credi-

tor in a sum exceeding two hundred dollars has made legal demand for payment, and the company has, for ninety days in the case of a bank, and for sixty days in all other cases, neglected to pay or secure or compound for the sum claimed.

**32. *Duties of liquidator.***—A winding-up order is granted upon a petition to that effect. Upon the petition being granted a provisional liquidator is appointed who takes possession of the company's assets and affairs temporarily. A meeting of creditors, shareholders and contributories is then called and a permanent liquidator appointed. This officer makes an inventory of the company's assets and a list of contributories (that is of shareholders whose stock is not fully paid), and proceeds to collect all debts due the company. He may be authorized to continue the business temporarily. When he has liquidated the assets, he prepares a dividend sheet of which he mails a copy to all interested persons. If the dividend sheet is not contested within a prescribed delay he pays any dividend and obtains his discharge from the court.

**33. *All claims may be proved.***—All debts payable on a contingency, and all claims against the company, present or future, may be proved. A claim for an uncertain amount will be given a fixed value by the Court. The holder of a bill of exchange may prove both for the amount thereof and for protest charges. Damages for breach of contract may be proved. Claims are proved by affidavit of the creditor or of someone acting for him.

34. *Bulk sales.*—In several of the provinces there exist Bulk Sales Acts. The general effect of these is that it is made the duty of every person who purchases a stock of goods in bulk and thus out of the usual course of business of the vendor, before making settlement by cash, note or check, to demand and receive from the seller a statutory declaration giving the names and addresses of his creditors and the amounts he owes. The purchaser is then to retain sufficient of the purchase price to pay these debts. If this is not done and the creditors are not paid, the whole transaction is deemed fraudulent and void, as respects any creditor who is prejudiced as a result.

#### REVIEW

What is the derivation of the word "bankrupt"?

What difference do you note between insolvency and bankruptcy?

Who may not become voluntary bankrupts?

What do you understand by acts of bankruptcy?

What is the difference between a referee and a trustee in bankruptcy?

Under what circumstances would you feel justified in filing a voluntary petition in bankruptcy?

## CHAPTER XVI

### CREDIT MANAGEMENT OF RETAIL STORES

1. *Effect of credit in retail selling.*—Altho credit sales in the retail business do not usually constitute so large a percentage of the total volume of sales as they do in the wholesale and the manufacturing business, they are nevertheless sufficiently numerous to demand the closest attention of the proprietor or manager. Efforts made to abolish retail credit in favor of cash sales have so far proved only partly successful. Such efforts are based on the contention that the giving of credit necessarily increases the selling price of the goods, since compensation for the inevitable losses that result from bad debts must be sought in that way, thereby saddling upon the prompt-paying customer the losses occasioned by the defection of the non-paying. Discounts ranging from two per cent to five per cent are frequently offered to customers as an incentive to buy on a cash plan. Trade coupons, or trading stamps, as they are commonly called, are used for the same purpose.

With a view to encouraging cash buying, certain large city stores have established banking departments for the use of their customers. The latter are invited to deposit their savings in the store's bank,

where interest at the rate of four per cent per annum is paid. When goods are purchased, the amount of the bill is simply deducted from the customer's balance on hand.

Experience shows, however, that in every city or town there is a large part of the population who prefer to buy their supply of food, clothing and other goods on credit, and to make periodical settlements for their purchases. In many instances, local conditions, as well as the manner in which the family income is received, make such an arrangement almost a necessity. Even where no such necessity exists, however, the inconvenience of paying cash for every purchase is frequently sufficiently marked to make a periodical payment plan decidedly welcome.

Whether, from an economic standpoint, retail credit or personal credit—of which mention was made in an earlier chapter—is desirable, is not here a subject of discussion. It cannot well be denied that frequently retail credit is both convenient to the customers and valuable to the merchant. Its value to the merchant depends, of course, upon the skill with which the store's credit is handled. Assuming that credit is given judiciously, it nearly always has the effect of binding the customers more closely to the store, and of securing for the merchant a larger number of their total purchases than would otherwise be the case. The customer who pays cash for everything he buys is likely to divide his purchases among a number of stores or to shift his trade at any time

from one store to another, while the person who has his purchases "charged" is likely to limit his trade to a very few stores. For this reason, many merchants in their advertising encourage credit purchases. The familiar slogan: "Your credit is good," is evidence of that fact.

Even so-called cash stores are rarely such in the absolute sense of the word. Persons who have established a reputation for ability and willingness to pay for all their purchases promptly at fixed intervals seldom find it difficult to arrange for credit accommodation. Such persons are, in fact, regarded by every merchant as ideal customers. Realizing the commercial advantage of possessing such a reputation, not a few customers make it a point whenever practicable, to establish credit relations, at the stores where they make their principal purchases. They are, of course, always scrupulously punctual in the matter of making settlement on the date previously agreed upon for that purpose. In case of reverses due to illness or unemployment, such persons are always able to command the necessary credit accommodation to tide them over their difficulty. The person who has neglected to establish such credit reputation at a time when he was not actually in need of credit, sometimes finds it difficult to obtain credit when circumstances make such an accommodation highly desirable.

2. *Customer's credit title.*—While the retail merchant may be willing enough to extend credit, he has

not usually, as we know, the same ready access to information about his credit-customers' financial condition, character and ability as the wholesaler has with regard to his. The wholesale merchant has recourse to the usual Dun or Bradstreet rating books, to financial statements and to credit reports. He can ascertain without any great difficulty whether or not his debtor is likely to pay for what he buys. The retailer has rarely any such sources of information to draw upon, altho of late years certain agencies have undertaken to furnish merchants with guides to the credit-standing and reliability of private individuals whose paying habits are known. Again, the retail merchant usually complies, as a matter of course, with the wholesaler's or the manufacturer's request for information about his property and his activities, whereas the retail merchant's customer is prone to regard such a request as little less than an impertinence.

At the same time, the retailer is approached by an unquestionably larger number of dishonest credit-seekers than the wholesaler. Every retailer has had experience with the professional "dead beat" who never pays for anything he buys unless actually compelled to do so. Moreover even among those whose integrity is unquestioned, the element of stability is often lacking. They are here today and may be elsewhere tomorrow; they may be employed this week and be without employment the next. Accordingly, the matter of directing the credits of a retail store—

especially of those stores that deal in goods of everyday consumption—is not always an easy task.

3. *Two important estimates.*—The retail dealer should determine as accurately as possible, first, what portion of his capital he can afford to have tied up in outstanding accounts; and second, how much credit may with safety be extended on each account. The former is necessarily determined by the amount of capital invested in relation to the periodical volume of sales, the latter, by taking into consideration the customer's financial strength and his reputation for promptness in paying his debts.

While that proportion of his capital which a merchant may with safety invest in outstanding accounts necessarily varies with the nature of his business, with local conditions, etc., such proportion is invariably too large if it prevents the merchant from paying his merchandise bills and other legitimate expenses when they are due. This is, in fact, the sole test.

Similarly, the test as to whether or not a retail customer has been given too much credit lies in the degree of promptness with which he pays his bills.

Where these matters are conservatively estimated and the estimate is faithfully followed, there is little danger that difficulties will arise. Where credit is extended, however, without regard to these factors, it is generally only a question of time when the merchant will find himself unable to meet his own credit obligations and when, as a result, he will be in danger of having bankruptcy proceedings instituted against

him, or of being exposed to such other measures as his creditors may take to deprive him of the control of his business.

4. *Discrimination in credit-granting.*—If the credit-seeker is one who possesses means, even tho he lack present command of them, he is ordinarily entitled to credit at the hands of the merchant. Cases of this kind differ little from those we have considered in our discussion of the wholesaler's credit practice. No country merchant hesitates to extend credit to his farmer-neighbor whose growing crops, tho still unharvested, give abundant assurance of their owner's ability to pay his bills in due time. In the same class may be put the salaried person whose regular income is sufficient for his wants, and who lives well within his means. Especially is this true if he is the head of a family and as such permanently located in the community. An unmarried man is regarded by the retailer with less favor as a credit risk. The same is true also of a married woman not legally responsible for her obligations.

The intemperate, the gambler, the manifestly incompetent, the shiftless and the idler are necessarily unworthy of credit favors, and should be made to pay cash for their purchases. Persons suffering from an apparently incurable disease are also regarded ineligible as credit customers unless, of course, they possess sufficient means to assure the payment of their account even in case of their death.

A good rule that may be followed with perfect

propriety in extending credit to "charge customers" is to put the burden of proof upon the credit-seeker. It is perfectly reasonable to assume that a person who desires to obtain a merchant's goods in exchange for a promise of future payment should be willing to state on what grounds he bases his expectation of being able to make the payment at the designated time. This is the principle upon which commercial credit is today asked and given. It should obtain equally where personal credit is sought.

5. *Understanding as to terms.*—In retail, as in wholesale, credits the amount of credit to be given and the date upon which payment is to be made are likewise subject to prearrangement. Once determined, these matters should be regarded with due seriousness. If they are not so regarded, it is generally the merchant's fault, in that he failed to impress upon the customer in the beginning the fact that he was expected to carry out to the letter his part of the agreement.

If the exact time of payment has been agreed upon in advance, it devolves upon the debtor, in case he becomes delinquent, to show cause why the amount is not paid according to agreement. Many merchants take the position of regarding the customer's payment of his debts as a favor, leaving with him the impression that such payment may be withheld if it is not entirely convenient to make it at the time it is due. This mistaken attitude is responsible for many bad debts and unpaid bills. A debt is always an obliga-

tion, and must be so regarded by both parties to the transaction. If an extension of time is desired it is the debtor's duty to obtain the creditor's permission for such extension. Payment cannot rightly be deferred without the creditor's consent. The principle applies to retail credits just as fully as it does to credits in a wholesale house.

6. *Opening an account.*—The majority of customers who desire to open a charge account in a retail store are women, and are frequently averse to being subjected to what they regard as inquisitorial methods on the part of the person in charge of the store's credits. Their traditional lack of business training tends to make them consider questions relating to their financial condition or to their family income as a reflection upon their honesty, nor do they always understand why they should be asked to tell at what stores they are in the habit of making most of their purchases. Accordingly the credit man, in his interview with the credit-seeker, must conduct the conversation as tactfully as possible, at the same time being direct and businesslike. If the credit-seeker seems unusually ignorant of business practice, the credit man should explain the why and wherefore of his questions as simply as possible but without "talking down" to his hearer. He should be able, in the course of a brief and pleasant conversation, to learn enough about the circumstances to determine in a general way whether or not the account is likely to prove desirable to the house. Some information as

to where the customer is trading at the present time, to serve as a basis for investigation of payment habits, should also be sought at this interview.

Many retail credit men go upon the assumption that a credit customer will always pay the first bill, and that it is subsequent purchases that need watching. Accordingly, unless the appearance and conversation of the customer plainly indicate the wisdom of the opposite course, they OK the order and at once accept the person as a charge customer and seek to obtain by means of outside investigation such information as will guide them in their subsequent handling of the account.

This procedure probably works well in many instances, but modern credit men feel that they should not be required to play the part of a detective in order to obtain data for a credit-grant of this nature. They feel that perfect candor should invariably characterize the interview between credit man and credit-seeker. Since, under the conditions which govern modern merchandising, the margin of net profit except in a very few lines of business, is small, and since losses must be carefully guarded against, credit men think that they should be given all necessary information at the time that application for credit is made.

Unquestionably, the latter viewpoint is—at least theoretically—correct; and it is highly probable that in a majority of instances the customer, whether man or woman, could be made to see the justice of this

contention if the credit man would urge it sufficiently. It would, however, be poor business policy to risk losing a desirable customer merely for the sake of securing his acquiescence in a principle. Hence the rule that in most instances of this kind is found practicable, may be briefly expressed thus:

Obtain all the information you can at the first interview, but carefully avoid offending the customer!

It is at this point that a knowledge of human nature serves the credit man well. Good common-sense, the ability to put two and two together, and a cheerful, optimistic attitude of mind, will usually enable him to reach a satisfactory conclusion without incurring the customer's displeasure.

7. *Corroborative information.*—It is not good business, however, to OK the first purchase merely on the assumption that since it is the first it will be paid. Means should be found for corroborating the favorable impression made by the customer at the time of the interview. To this end a card is usually made out, upon which are entered the customer's name and address and the occupation and business address of the husband (if the customer is a married woman). Another bit of desirable information is whether or not the family owns its residence. A notation of the credit limit and of the dates of payment is also desirable, since such a record makes the subsequent rendering of bills a matter of course, just as it permits the merchant to notify the customer at once

when the account has reached the previously determined high mark.

The credit man now has several avenues of information open to him. If the head of the family is in business for himself his rating may be looked up in Dun's or Bradstreet's. If he is not, his employer may be communicated with, and information may be obtained with regard to the industry and the moral character of the credit-seeker. Frequently additional information may be obtained from the same source with regard to property owned or to savings in the bank. It is quite possible that the information thus obtained may prove sufficient for the credit man's purpose.

Should he require additional data, however, the credit man may consult the landlord (in case the family live in a rented house) as to whether the rent is promptly paid; just as he may learn from inquiry among the grocers and butchers in the neighborhood whether the customer is in the habit of paying with regularity for his meats and provisions. Much of this information can be obtained by telephone within a single hour. Even should it be necessary to send a representative to the customer's neighborhood it would rarely require more than a few hours to complete the investigation. If the information elicited appears satisfactory, and if it agrees in all important features with the statement made by the credit-seeker at the first interview with the credit man, there is every reason to believe that the account will prove satisfactory, so long as it is given proper attention

thereafter by the store in the matter of payment dates and credit limit. Should the investigation reveal any material discrepancies in the credit-seeker's statement, or should the information obtained be in any respect unsatisfactory in whole or in part, the credit man will at least have been given fair warning, and if he nevertheless decides to grant the credit, he will not fail to take such steps as he may deem necessary to safeguard the account.

8. *Watching the account.*—If the account is accepted, the credit limit is entered upon the customer's ledger account so that the bookkeeper will always have it before him when he enters a charge item, and so that he will be able to give prompt notice whenever this limit is approached too closely, or by any possibility is exceeded. The limit is rarely passed, however, in a well-managed store, since information pertaining to every charge customer's account is usually placed in possession of either the clerks, in smaller stores, or the inspectors and floorwalkers, in larger ones. In every case, the credit man's attention is to be called to the account as soon as this comes within a certain distance of the assigned limit.

From this point on, it is chiefly a matter of tactful handling of the customer with a view to keeping the account in proper condition and preventing delinquency in payments.

9. *Credit interchange among retailers.*—As has already been noted, the retailer, much more than the

wholesaler, is exposed to loss at the hands of the professional "dead beat." Strange as the fact must seem to the average person, there are not a few whose philosophy of life forbids the payment of any debt if by any means its payment can be evaded. Such persons are not easily "spotted" since they usually dress well, live well, and in every respect give an impression of being respectable and trustworthy persons. But true to their principles, at the proper moment they invariably leave confiding creditors to mourn their disappearance. It is for this reason that of late years the tendency to organize for mutual credit protection has been developing rapidly among retail merchants. It no doubt occurred to such merchants that it might check the operations of the "dead beat" in their territory if they compared notes on the subject and sought information from one another before opening a new charge account. Today there are found in many of our cities cooperative associations organized for that purpose.

The merchants who constitute the members of these associations agree among themselves to refuse credit to any person who is a delinquent customer of any one of them. By assuming this attitude they practically compel all customers to pay their bills promptly. The associations also investigate the financial responsibility of new residents and of others who apply to local merchants for credit. The chief economic value of the activities of such associations is probably that they seek by word and action to impress upon the

public the fact that higher prices of commodities are the inevitable consequence of irregular payment habits, since the losses inflicted upon a merchant by his non-paying customers must of necessity be borne by the honest and prompt-paying patrons of his store, in the form of higher prices paid for commodities. This aspect of the movement tends to secure for it the intelligent, active support of the better class of persons in the community.

In some instances these associations, thru assessment of their members, provide the necessary funds for the maintenance of a local office and for the employment of a secretary-in-charge. In other instances, the associations are private enterprises maintained for profit, local merchants being admitted to membership upon payment of an annual fee.

In the larger cities, such associations do not usually include merchants of more than one line of business, tho merchants of closely allied lines are generally admitted to the same association. In smaller cities the associations may include not only merchants of every kind but professional men, bankers, real estate agents, insurance agents, loan agents and others.

10. *Two systems.*—The systems commonly employed by retail credit bureaus are of two kinds. One is what is sometimes called the “affirmative-negative” system; the other, the “negative.” The name of the first indicates that the bureau collects and records information of every kind, both favorable and unfavorable, that has any bearing upon the credit-standing

of a customer. The negative system concerns itself solely with credit information of an unfavorable nature. The latter system, tho possessing certain definite advantages, notably the savings of time and labor, has this disadvantage, that its records really constitute a "black list," whereas there is not always absolute certainty that a person listed as "bad pay" really deserves such designation.

The negative system has the further disadvantage that it does not make room for that large class of customers who, altho never prompt in paying their bills, eventually pay them—some taking longer time than others. In what is known as an affirmative-negative system, room is left for suitably designating such customers without having to class them as bad pays. This is clearly of advantage to the merchant, just as it is only fair to the customer.

11. *Rating blanks*.—In some organizations a request for credit information is sent to every newcomer in the community. The request is usually in the form of a letter inclosing a slip upon which are printed spaces for recording name, address, occupation, employment, age, etc., and for answering questions, such as "How many in family?" "Do you own real estate?" "Where have you lived before coming here?" "Of what church, if any, are you a member?" "What lodge?" "Of whom did you chiefly buy in your former place of residence?"

The letter accompanying the inquiry slip is usually prepared in fac-simile typewriting, and is a courteous

request for cooperation in the bureau's effort to establish the credit reputation of all persons who are in the habit of paying their bills promptly, and thereby to protect local merchants against those who do not pay their bills.

Failure to comply with this request for information is by no means to be regarded as proof that the person has something to conceal or as indicating that he is undesirable as a credit customer. However, such failure suggests that the person should be visited by a representative of the credit bureau and that the aim and object of the bureau should be carefully explained, at the same time that information about the newcomer is sought first-hand.

12. *A typical credit bureau.*—In a certain city in Ohio an organization of grocers, numbering over five hundred, maintain a reciprocal credit information bureau. The operation of the bureau is as follows:

Each participating member files with the secretary of the association the names of all his customers, together with such information as he may possess relating to their credit-standing. This information covers, as far as possible, the value of each customer's possessions. It also states the highest amount of credit thus far allowed him. Furthermore, it includes, whenever possible, an estimate of his moral character, his earning capacity, his habits and his attitude toward paying his debts. The report covers a wide range of information, often embracing the amount of fire-insurance carried by the customer, and

at times even including the social aspirations of his wife, and the ability of the family to live within their regular income.

This information, when it is received at the bureau, is entered upon cards and arranged by the secretary for ready reference. Upon application from a member, the secretary answers such questions relating to the customer's credit-standing as may be answered from the information at hand.

Suppose a charge customer has just moved from one section of the city to another and that he now wishes to open a new grocery account. The grocer to whom he applies for credit immediately puts himself in touch with the secretary of the association in order to learn how the customer has treated his payment obligations in the past. If this investigation shows the newcomer to be in arrears, credit will be refused him until the old debts are paid.

13. *A unique credit bureau.*—In Medicine Hat, Alberta, Canada, a unique retailers' credit association is in operation. The merchants in town file with the secretary of the association all unpaid accounts owing by individual customers. The secretary makes claim upon each debtor for the total of the amounts that he owes to members of the association. As collection is made, the amount collected is divided among all the accounts *pro rata*.

In this bureau, records are kept of each charge customer, showing full name, present address, business position, earnings, property, etc.

It is an integral part of this plan that no credit account shall be opened with any customer until the approval of the credit bureau has been obtained. The person applying to a merchant for credit is directed to obtain a credit card from the secretary of the bureau, it being explained to him that under the regulations which govern the giving of credit by local merchants, no store is permitted to open a charge account until authorized by the secretary of the bureau.

The plan is said to work very well. It possesses a special value in that it places the customer in immediate contact with the credit bureau, with the result that he becomes duly impressed with the necessity of paying his local bills promptly if he is to enjoy the privilege of having his purchases charged.

Another feature of this plan is that each member of the association makes a monthly report to the secretary of the bureau upon the status of each charge customer's account. By means of these reports, it is at all times possible for the credit bureau to ascertain the total amount owed by each customer. Payments on account are reported weekly.

Under this plan, as will be seen, the credit bureau acts as credit man for the entire membership, thereby relieving the local merchants of the burden of investigating each applicant for credit. Whether, in the long run this advantage will outweigh the apparent disadvantage of such impersonal credit relations is perhaps too early to say. It is at least conceivable that the closer and more intimate relations

between merchants and customers, which is regarded as one of the chief advantages of carrying charge accounts will, under the system described, be less marked. So long, however, as every merchant in the town belongs to the association and is governed by its rules, the advantages or disadvantages will of course be equally divided. But if some merchants should refuse to join the association, they might be able to turn this division of advantages and disadvantages to their own account.

14. *Instalment house credit.*—The purchasing of goods on instalment has become popular with a large number of persons. It is chiefly in the furniture and house-furnishing lines that this form of sale has become extensive, tho the practice is not by any means limited to such goods. Books, jewelry, and clothing are commonly sold on this basis.

At one time the buyer of goods on instalments regarded the instalment house chiefly in the light of a benefactor and friend of the person of small means. This view has now largely passed away—probably as a result of the keen competition that of late years has developed in the instalment house business.

At first glance, it may not appear that instalment credits differ in any material sense from ordinary retail credits, since both involve selling to private individuals on a promise of future payment. There are, however, several important points of difference.

In the first place, the instalment house cannot be quite so discriminating as the ordinary retail store

in the selection of its credit customers. While a large number of "charge" customers in the city department stores seek credit solely for the sake of convenience, those who seek credit of the instalment house are usually such as could not easily buy on any other payment terms. Hence, the instalment house credit man must not expect to find in the customers of his house any strong financial basis for credit. If they appear to be honest, industrious and capable of earning a moderate wage, he must as a rule accept them as customers. This apparent disadvantage, however, is compensated for by another factor which is absent in ordinary retail credits, and which therefore constitutes another point of difference. The instalment house invariably secures itself by means of a lease or a mortgage upon the property sold to the customer, so that in case payment should not be made according to the terms of the sales contract, the house may repossess itself of the goods sold.

There is, of course, always a possibility that the instalment house customer may move to other parts before he has paid for the goods, or that he may otherwise attempt to defraud the house. Under the terms that surround the instalment contract, however, this becomes a rather dangerous experiment, and few will risk it, even if they are not above resorting to such practices.

15. *Points to be observed.*—One of the first points to be observed in handling credit transactions of this nature is that a substantial first payment be obtained.

This has a double purpose. In the first place, it goes far toward covering the cost of the goods, thereby reducing the amount involved in the risk that necessarily must be assumed; in the second place, it offers greater assurance that subsequent payments will be made, on the principle that the buyer usually feels that he cannot afford, thru non-payment of the balance due, to forfeit the amount already paid on account.

Credit decisions in the instalment house business must almost invariably be made at the first interview, for if decision is postponed, the sale is likely to be lost. Usually, the customer will have inspected the goods and decided to buy them before he (or she) makes it known that credit is desired. When the credit man interviews the customer, he must endeavor to reach a conclusion as quickly as possible and without too much direct questioning. The customer's financial condition and paying ability must be gauged by the nature of his employment, the size of his family, the street in which he lives and similar items—information that may usually be elicited in a brief conversation. Certain other information that may be necessary and that can be obtained only thru direct questioning, should be asked as tho it were merely a matter of form required by the established rules of the house.

Some of this information may subsequently be verified by investigation, and it is generally wise to ob-

tain such verification, but beyond checking up the address given, the place of employment and perhaps one or two other items, little outside information is obtained.

A comparison of the statements made during the interview will usually tell the experienced credit man whether the customer is giving a straight account of himself and of his income, and whether the purchases just made are warranted by the size of his income. If, for example, the wife of a man whose wages are known to be sixty dollars a month, comes to the store and buys on instalment an oriental rug costing \$200, the credit man knows at once that this is not a wise purchase, and he rightly concludes that the person who displays such poor judgment in buying for her household is not a safe credit customer.

One credit man who has charge of an extensive instalment business in musical instruments, frequently procures corroborative information of a prospective customer's statements in the following manner:

Suppose a new customer has given his occupation as that of foreman in a certain plant. The credit man, in order to check this statement, calls the plant on the 'phone and announces that he wishes to speak to "Mr. Smith, your foreman." If the telephone operator answers: "We have no foreman by that name," the credit man knows that there has been misrepresentation. If, on the other hand, the operator answers: "Just a minute!" or otherwise indicates

that the person is really a foreman, the credit man quietly hangs up the receiver. He has obtained the information he sought.

16. *An element of danger.*—Not many of those who come to the instalment house for credit intend to defraud the seller, tho a few undeniably do. The professional dead beat is just as likely to turn up at the instalment furniture store as at the corner grocery, and is usually as difficult to “spot” in one place as in the other. It may be said, however, that the great majority of credit seekers fully intend to pay their indebtedness, but laxity in the matter of regulating their expenditures, failure to take proper account of all their necessary expenses, and to make allowance for idle days or weeks, frequently bring to naught their good intentions and render them unable to meet their promised instalment payments. This is the difficulty that always presents itself to the credit department of an instalment house, and that compels the credit man to exercise unceasing vigilance. From this point on, however, the matter is one of collection policy, which is a subject dealt with in another chapter.

## REVIEW

If you were a retail merchant doing a credit business, what main considerations would guide you in determining the extent of your credit operations?

In interviewing persons who desire to open a charge account in your store, what attitude would you assume with regard to the relation of debtor and creditor?

How would you go about looking up the credit standing of a new customer?

## **CREDIT MANAGEMENT: RETAIL STORES 285**

**What economic service is rendered by the various retailers' credit associations?**

**What advantages and what disadvantages are found in installment house credits as compared with those of the ordinary retail store?**

## CHAPTER XVII

### THE COLLECTION DEPARTMENT

1. *General collection principles in a wholesale house.*—Every credit transaction, as we have seen, is in the nature of a contract, by the terms of which the seller surrenders title to merchandise or other valuable commodities in return for a promise of payment to be made on or before a specified date. Accordingly, not until such payment is made has the buyer carried out his part of the contract; not until then is the seller again in possession of his capital; not until such time is his profit on the transaction actually enjoyed.

A good collection policy demands that this contractual feature be kept constantly in view, yet experience shows that frequently it is neglected. Great laxity commonly obtains in the matter of making remittances in accordance with the terms of sale. For that reason, efficient collection methods are indispensable to the success of business in which goods are sold on credit. In the case of a manufacturer or wholesaler, the collection department is an invaluable adjunct to the credit department.

Even with the best of equipment, and with the exercise of the most diligent effort, credit losses cannot

be wholly prevented. In nearly every wholesale business, however, it is possible by means of proper credit management to keep such losses within a fraction of one per cent of the yearly sales. It must ever be the credit man's aim to reduce the percentage of losses to the lowest possible point, so long as he is not thereby unduly restricting the volume of credit sales.

The proper time for the credit man to consider whether an account will be promptly paid is before that account is opened. Undoubtedly, it would greatly simplify the work of the credit department if early attention were given each account. "How much credit do you wish?" a certain merchant was in the habit of asking every applicant for credit. The latter would mention the amount desired and the length of time for which it was wanted. "All right," the merchant would say; "I'll grant you all that you have asked, and in order that there may be no dispute later, I will enter the date right now and here on your account in the ledger. But now that I have agreed to your terms, I want it understood that you are not to ask me for any extension. I shall expect you to live up to the terms which you yourself have made."

This is unquestionably a correct attitude on the part of the credit-grantor, and it is in perfect accord with the collection policy here recommended. Prompt payment of accounts due is never to be regarded as a favor or to be referred to as such. Plainly, it is no more a favor for the debtor to remit promptly than

it is for the creditor to ship the goods according to the terms and conditions of sale.

Nor is there any doubt that the house which insists upon receiving prompt payment is more highly respected by its customers than its easy-going competitor. Usually the former is paid on time, while the latter has to wait. Experience shows, moreover, that the maintenance of a prompt-payment policy drives away no desirable trade. The points to be observed in the adoption and maintenance of such a policy are simply that a thoró understanding of the credit terms which are to govern the sale are had before the order is filled, and that no deviation from these terms be permitted, save for perfectly valid and mutually satisfactory reasons.

2. *Three causes of delinquency.*—When an account remains unpaid after the date of its maturity, it is called a collection, and as such becomes subject to handling by the collection department. In the larger houses, this department is generally distinct from the credit department and has its own head, who works in close association with the credit man. In smaller houses the joint functions of credit man and collection manager are usually assumed by one man.

If a customer fails to pay his account at maturity, one of three causes is responsible:

1. Carelessness.
2. Inability to pay.
3. Unwillingness to pay.

Whatever may be the cause of delinquency, the

credit man or the collection manager must ascertain what it is at the earliest possible moment, for upon this knowledge necessarily depends his selection of the remedy. Where mere carelessness is the cause, the right kind of pressure promptly applied will usually bring the money, accompanied by an apology for the oversight. If, on the other hand the customer is really unable to pay, it is evident that pressure is not the remedy to be applied. In that case, the solution of the difficulty may lie in the offering of additional credit with a view to enabling the delinquent to tide over his temporary difficulty. But where the real cause of the delinquency is unwillingness to pay, it is obvious that neither persuasion nor assistance will meet the situation. Here summary action—even drastic, perhaps—is demanded, and must be instituted without delay if the account is to be saved. The unwilling debtor must either be forced to pay, or he must be made to suffer for his unwillingness.

Fortunately, only a small proportion of delinquents are of the unwilling kind, tho it sometimes happens that thru the creditor's faulty handling of the case, a debtor who originally was in class 1 or class 2 eventually drifts into class 3. This shows that early information as to the real cause of the delinquency and prompt action in accordance with the requirements of each case are the chief features in the formulation of an intelligent and effective collection policy.

3. *The monthly statement.*—A common practice in a wholesale house is to send statements of accounts to

all debtors on the first of the month, these statements serving as a reminder that the amount is either due or about to become due, and—where the account remains unpaid—to send statements at regular intervals rubber-stamped with variously-worded requests for an early remittance.

What is regarded as a better plan is to time the sending of the first statement so that it will reach the debtor a day or two before the account becomes due; and not to send any subsequent statements with requests for payment. The arrival of the statement just before the date of maturity, makes it impossible for the debtor to offer as an excuse for non-payment that he had “overlooked the matter.” The arrival of the statement at such a time also plainly reminds him that the prompt payment of his bill is not a matter of indifference to his creditor. If this reminder goes unheeded, however, recourse should at once be had to other and stronger means.

4. *The collection letter.*—The next step usually consists in sending a letter. Bearing in mind that the creditor’s attitude toward a maturing account, as far as this attitude is observable by the debtor, should always be one of confident expectation of payment at maturity; and in view of the fact that this expectation now has been disappointed, a letter is immediately sent to notify the debtor of the non-arrival of his remittance. Such a letter should reveal no uneasiness on the part of the collection manager with regard to the debtor’s omission; but should somehow

convey the impression that the delay is causing some surprise and that it is interfering with the routine of the department.

To omit sending such a letter, even for a few days, suggests to the debtor that the creditor is not very much concerned over the delay in payment. If such a letter is not sent promptly, the debtor is led to infer that the creditor does not need the money and that he is willing to have the debtor take his own time in making the payment. Once this impression is given—especially in the case of a new customer—it will generally be found that the debtor takes full advantage of the situation, and thereafter consults only his own convenience in making payments. He may even resent subsequent requests for payment, regarding them as unwarranted and offensive reflections upon his ability and willingness to pay his just debts.

The use of printed or mimeographed letters for this purpose is usually to be condemned, because these are likely to suggest to the debtor that tardiness in the payment of accounts is of frequent occurrence among customers of the house—the very impression to be avoided. Tho form paragraphs and standard letters are often used, each letter should be written separately and be made to fit the occasion, for this procedure conveys the impression that the occurrence is unusual and that the matter is regarded by the creditor as decidedly important.

If the first letter fails to bring a prompt reply, a second should be sent immediately. The second let-

ter, while still confident in tone, should express surprise at the debtor's continued silence, and may properly inquire whether misfortune of any kind has overtaken him. It may even, in evidence of the creditor's confidence, express readiness to render financial assistance, if such is needed.

In each case, circumstances will necessarily determine, to a large extent, the kind of letter to send the delinquent. All such letters, however, should have this in common: they should invariably make clear the credit man's insistence on being informed of the actual cause of the non-payment of a past-due account. Needless to say, such letters should invariably be courteous in tone and even sympathetic in expression, in order that they may invite the confidence of the debtor.

Possibly, however, the first letter brings a request for an extension, and gives what appears to be good reason for the debtor's present tardiness. If this request is granted, a definite payment date should be set and there should be an understanding that no further extension is to be asked. At times it is better to grant even a little longer extension than the delinquent asks for, since by such generosity the creditor emphasizes both his anxiety to accommodate his customer, and his expectation of receiving payment promptly upon the new date granted.

5. *A letter with a notice of a draft.*—If, however, the credit man's first letter fails to bring a prompt answer a second letter should be sent without

delay. This letter may contain notice of the intention to draw upon the creditor for the amount due, and fix a date when this is to be done. The date is set just far enough ahead to permit an answer to be received by mail. Unless before that time the debtor remits or writes, the draft goes forward as announced, payable to the debtor's bank (if known).

There was a time when to dishonor a draft was virtually to declare oneself insolvent. Such is no longer the case, and little is thought nowadays by the average dealer of returning a draft unpaid. Nevertheless, the draft, even tho it may not bring the money, usually elicits some expression from the debtor as to his position or his intentions, and thereby gives the credit man a valuable clue to the course he should follow in order to effect a collection of the account as speedily as possible. The draft is frequently the means of inducing a delinquent to pay, for he naturally does not wish the bank to learn of his delinquency.

Some credit men prefer to send the draft to another bank in the debtor's town, on the principle that the stranger-bank will be more prompt than the debtor's own bank in presenting the draft for payment. It is doubtful whether this advantage is a real one.

Formerly banks received and presented drafts free of charge, but since the largely increased use of drafts in the collection of accounts has made this service increasingly burdensome, banks now usually require a small fee for their services. At a cost of ten, fifteen or twenty-five cents, drafts may be sent to the debtor's

bank for prompt presentation and for return, with notice of reason for non-payment when the debtor fails to honor the draft. On sending a draft to the bank for collection, it is advisable to inform the debtor that the draft is under way, so that he may have an opportunity to provide the necessary funds before the draft is presented by the bank.

6. *When the draft is ignored.*—Frequently a draft will be returned with the notation, "No attention," indicating that altho the bank gave due notice to the debtor that it held a draft against him, the latter ignored the bank's request that he honor it. In that case, another letter should at once be sent. Possibly also another draft may be presented thru another bank; if this is done, the letter courteously assumes that notice of the former draft was not received by the debtor in time for him to take up the matter with the bank, for which reason another opportunity is to be given him. Such a letter might read as follows:

Dear Sir:

The Fourth National Bank of your city has returned to us our draft on you, dated April 25, for \$——. The bank's notation indicates that altho you received due notice of the draft, no attention appears to have been paid to the matter. Inasmuch as we took pains to inquire in advance what your wishes were with regard to the draft, we necessarily assumed, since you did not notify us to the contrary, that you would honor the draft on presentation. Had you definitely indicated your preference as to manner of payment, we should, of course, have been glad to respect your wishes.

We think it is possible, however, that the bank was remiss in the handling of this item, and that you received the notice

only when it was too late to enable you to prevent the return of the draft. We shall therefore draw again on (date) thru Farmers and Mechanics Bank, unless we receive word from you to the contrary before that date.

Please bear in mind, Mr. —, that we expect from you either a prompt payment or an explanation of the delay. We are perfectly willing to consider any good reason you may have for not paying this amount promptly, but we cannot agree to be kept in ignorance of the cause of this delay or of your intentions in the matter.

With renewed assurance of our high regard, and awaiting with confidence your early reply, we are,

Yours very truly,

Assuming that no reply is received to this letter, the second draft is sent promptly on the date mentioned in the letter.

Should the second attempt meet with no greater success than the first, the futility of that course is thereby fully established, and the use of other—and stronger—means for the collection of the debt are thus plainly indicated. Usually the next step is to send the claim to an attorney for collection.

7. *Taking legal proceedings.*—Under ordinary circumstances, however, not until repeated efforts have been made to learn from the debtor the real cause of his delinquency should the services of an attorney be sought. If the debtor takes his creditors into his confidence and explains his circumstances, some satisfactory disposition of the matter is nearly always possible. But where this information, despite repeated requests, is withheld, the credit man or the collection manager has no choice. The situation is

now becoming grave and he must do what he can to guard the interests of his house. Tho with the almost certain prospect of losing a customer, he must at this point endeavor, by outside help, to enforce payment.

When this stage is reached, the debtor should be informed that the claim is about to be placed in the hands of an attorney for collection and that if he desires to prevent this step being taken, he must remit or explain before a certain date, which is fixed, as formerly, just far enough ahead to permit an answer to be received.

If the debtor still remains silent, no further direct dealings with him should be had. From this time on—at least as far as the debtor knows—the attorney in whose hands the matter is placed is in full charge of the case. The attorney should be urged to do his best to collect the amount of the claim without delay, or, failing this, to obtain security in the form of a properly indorsed note.

8. *A choice of methods.*—The attorney who has been intrusted with the claim has now two courses open to him. He may endeavor to effect a settlement amicably, or he may bring suit in court for the amount of the claim and the court fees as well. His course will be governed by conditions as he finds them. Possibly the debtor is so situated that a judgment of court against him can not be executed, in which case it would manifestly be a useless procedure to sue for the purpose of obtaining such judgment.

Or, the debtor's business assets may be sufficient to

insure a judgment. Even so, however, the attorney, rather than sue the creditor, will endeavor to induce him to pay the claim tho in case persuasion proves unavailing, the filing of suit is the only alternative.

A frequent mistake on the part of the credit man is to delay sending the claim to the attorney, in the hope that the firm may be able eventually to persuade the debtor to settle his account and thereby save the cost of collection by attorney. This is, as a rule, a mistaken policy, inasmuch as with each day's delay the difficulty of effecting a collection increases. If the debtor fails to respond to the efforts of the credit man, it is safe to conclude that the claim should be placed in the attorney's hands at once. To do otherwise is to jeopardize the collection.

It may happen, however, that a debtor disputes the claim and sets up a counter-claim of rebate for inferior or defective goods, belated shipment, or the like. In that event, the case may involve litigation. But litigation always increases the cost of the collection, and the creditor may be unwilling to incur such costs, especially if he has a fear that despite the justness of the claim, the case may go against him, owing to the tendency which still obtains in many sections of protecting the local debtor against the foreign (or outside) creditor.

The attorney, after looking into the situation, will usually recommend the course to be taken, and will await the consent of the creditor before taking legal steps to enforce payment. If suit is to be brought,

he will generally demand that the client forward court costs.

In selecting the attorney in the debtor's town to whom the claim is to be sent, the creditor usually consults one of the law lists or attorney directories, to which reference has already been made. He forwards the claim under the guarantee of the law-list publisher, who usually offers to be responsible for the prompt payment of all moneys collected by the attorneys on his list, provided he is promptly informed by the forwarder of the claim when and to whom the claim is being sent. Of this, however, more later.

9. *A wrong mental attitude.*—What must be regarded as a serious mistake in the composition of a collection letter is the attitude not infrequently assumed by the credit man who undertakes to offer excuses for requesting payment of a past-due account. "We regret that we are compelled to ask you for a remittance but we have some unusually large payments to make within the next few days, and we sincerely trust you can help us out by sending us a check for the amount of our bill. If you cannot send the entire amount, send at least a good part of it." This is a form of collection letter which is common enough, but which invariably weakens the collector's hands and that usually puts the collection of the claim further off than ever.

Such a letter is harmful—in the first place, because the debtor is not likely to believe the reason alleged, even if it were strictly true—which in all probability it

is not; in the second place because, as a collection argument, it is extremely illogical. The debtor may rightly argue that he and his creditor appear to be in precisely the same condition: both must make collections before they can pay their bills. Accordingly, he cannot be expected to pay his debt until he has collected the necessary amount from his debtors. And since collections at this time are very bad (they always are at such times), it will, of course, be impossible for him to "help out" the supply house with a check, however much he may wish to do so. The creditor, by his unwise attitude, has furnished the delinquent with the very argument he desires for not paying his bill.

Looked at from the creditor's standpoint, the prompt payment of a debt is a *right*, and from the debtor's standpoint an *obligation*. For the credit man or the collection correspondent to permit any other view of the matter to appear in his letters to a delinquent, is to yield an important advantage. This view of the subject is by no means incompatible with the display of perfect courtesy, or even with the manifestation of a kindly personal interest in the debtor. Needless to say, discourtesy and grouchiness have no more place in a collection letter than in a sales letter.

10. *Use of the collection agency.*—As a medium between the wholesaler-creditor, on the one hand, and the attorney in the debtor's town, on the other, the modern collection agency has come to fill an important place. Many wholesale houses choose to forward their claims thru a good collection agency in

preference to sending them to the attorney direct. The cost to the creditor is the same, whatever method is selected, but it is usual for the attorney to divide his fee with the forwarding agency, in the proportion of two-thirds to himself and one-third to the agency. Opinion is divided as to which of these methods is the better. On the one hand, it is claimed by the advocates of direct forwarding that the claim receives better attention when no division of attorney's fees has to be made; on the other hand, those who favor forwarding thru an agency insist that such a house has a distinct advantage in a fuller knowledge of collection work and in the possession of better equipment for the efficient handling of claims than that which is commonly possessed by the ordinary wholesale house.

Of this more will be said in the next chapter: we merely note here that in a large number of instances better and speedier collection service is undoubtedly secured thru the modern, efficient collection agency than can ordinarily be obtained by the creditor who forwards his claims direct.

11. *The adjuster.*—The modern tendency in credit management is for creditors to cooperate in their dealings with weak or insolvent debtors. The provisions of the National Bankruptcy Act have probably done much to encourage this practice. While in Canada, as we have already seen, there is no national Bankruptcy or Insolvency Act, there is a growing tendency among creditors to give a deserving trader

a chance to improve his position. Formerly many a temporarily embarrassed debtor was plunged into bankruptcy by the pressure of creditors anxious to obtain their money in advance of other creditors. As the law now insures a *pro rata* distribution of assets among all bona fide creditors of an insolvent estate, the temptation to force collections under such circumstances is considerably lessened, and the benefit of concerted action is increasingly realized. Frequently, with the exercise of a little patience on the part of the creditors, and under the direction of some competent person, the unfortunate debtor may be able to reinstate himself and eventually to pay his debts in full. Many of the larger and better collection agencies maintain adjusters who on short notice will visit the debtor, look over his situation, and take such steps as will be for the best interests of both debtor and creditors.

Not infrequently, the creditors, after sending an adjuster to investigate a debtor's affairs, see the wisdom of accepting a certain percentage of their claims as payment in full rather than throwing the debtor into bankruptcy. This lifts the burden off the debtor's shoulders and permits him to start anew under more favorable conditions.

12. *Taking unearned discounts.*—Many a dealer who never would take a five-cent piece belonging to another, appears to have no conscientious scruples about taking a cash discount to which he is not en-

titled, and frequently regards it as little less than an insult to be reminded by the wholesaler that the terms of sale are to be observed according to the letter.

Let us suppose the terms of sale to stipulate a cash discount of two per cent for making payment within ten days—which is a custom that obtains in many lines of business. The purpose of such a discount is, of course, to induce an immediate payment. Obviously, it is most unfair for a debtor to deduct the cash discount when he does not make payment until after the ten days have elapsed; yet this is just what is being done by many, and it is causing much annoyance and actual loss to the creditors. Fifteen, twenty, and even thirty days are taken by some customers who nevertheless invariably deduct the cash discount before remitting the amount of their bills.

Not a few wholesale houses, for fear of losing the dealer's trade, submit to this form of exploitation without protest; others, tho they may make mild protests concerning the irregularity of the practice, fail to take a positive stand in the matter. Some, and their number is happily growing larger each year, decline to submit to what they regard as a dishonest practice, and invariably charge the dealer with any sum, however small, that has been unjustly deducted in the form of a cash discount. The latter course, in addition to being the only right one from a moral standpoint, has the advantage of inculcating in the debtors' minds a wholesome respect for the house that pursues it, and a corresponding confidence in its goods

and service. It is the practically unanimous testimony of those who have put themselves on record as absolutely opposed to the abuse of discount terms, that this attitude has caused the loss of no desirable customer. Moreover, it is found that a frank and courteous statement of the attitude of the house in the matter of the observance of discount terms is usually sufficient to convince any dealer who is in the least degree fair-minded, that the practice complained of is wholly without justification in equity and morals.

13. *Charging interest on deferred payments.*—The same line of reasoning that condemns the deduction of unearned cash discounts insists upon the payment of interest on every past-due account. Yet in many instances the obvious justice of this stand is ignored by buyer and seller alike. Accounts that are sold “net thirty days,” are frequently not paid until forty-five or sixty days have elapsed—at times not even then.

The wholesale house that consents to have payment deferred in this manner, is virtually lending its capital to the delinquent debtor without any compensation whatever. Since the debtor, if he were to borrow the money at the bank, would have to pay interest upon the loan, there appears to be no good reason why the wholesaler’s capital should not be entitled to equal earnings while in the debtor’s possession beyond the regular credit period. As a matter of fact, the wholesaler is really entitled to more than the usual five or six per cent per annum, since under ordinary circum-

stances he could earn more than that by employing the money in his business.

As with the custom of taking unearned cash discounts, so also the matter of paying interest on past-due accounts is largely a question of right attitude on the part of the creditor. Experience shows that the evils complained of can be removed whenever a correct policy is adopted and consistently maintained. The exercise of a little tact will often go far toward making a customer, who has been guilty of such practices, see the evil of his ways and change for the better.

14. *Defective remittances.*—In the usual work of the credit and collection departments, it happens now and then that a letter is received which is said to contain a check, when, as a matter of fact, no check is inclosed. While such omission may be merely an oversight, it may be—indeed it frequently is—an attempt on the part of the debtor to gain time. A practical way of dealing with such a case, if it is suspected that the check was intentionally left out, is to make a draft on the debtor thru the bank, advising him at the same time in a courteous manner that, inasmuch as the absence of the check was evidently caused by an oversight, this step was taken in order to rectify the mistake. The debtor cannot very well, under the circumstances, refuse to honor such a draft when the bank presents it for payment.

Another device occasionally resorted to by a debtor in an effort to gain time, is to send an unsigned check

or a check made out to the order of the debtor but not indorsed by him, to the creditor. In the former case, the check should at once be deposited in the bank, the amount being guaranteed over the creditor's signature. The debtor should be informed of the step taken, and a suggestion should be made that he affix his signature to the check when this in due time is presented by his bank. In the latter case, where indorsement to the creditor of a check made out to the debtor is omitted, it is permissible to supply the missing indorsement over the creditor's signature and deposit the check in the usual way. The debtor's letter which accompanied the check, and in which he announced the inclosure of check for a certain amount, should be carefully preserved as constituting the creditor's authority for taking the step.

So, also, whenever a check offered in payment is improperly made out, the correct amount should be written on the back of the check and guaranteed correct over the creditor's signature; after which the check may be deposited and the remitter may be promptly notified.

### REVIEW

What three causes are generally responsible for the delinquency of a merchant, and what methods would you, as a collection manager, employ in each case?

In the matter of sending monthly statements of account, what do you regard as the better plan: the sending of a statement on the first of the month, irrespective of the due date, or the sending of one just before the due date? Give your reason fully for recommending the practice of which you approve.

Describe the general attitude to be assumed by the collection manager in corresponding with a delinquent debtor.

What do you consider the chief value of the draft as a step in the collection of a past-due account? What disadvantages has the draft in such a case?

What is your preference—and the reason for it—with regard to forwarding out-of-town claims—direct or thru a collection agency?

## CHAPTER XVIII

### THE COLLECTION DEPARTMENT (*CONTINUED*)

1. *The commercial lawyer.*—Efficiency in the collection department depends in no small degree upon making proper use of the commercial attorney in the collection of claims that the manager is unable to collect with the means at his disposal. It will be well therefore to consider briefly some of the points that frequently come up in connection with the selection of such attorneys, and with the direction of their efforts when claims have been placed in their hands. In nearly every town thruout the country there is at least one lawyer who gives special attention to commercial matters, such as collection of claims by litigation or otherwise, the furnishing of credit reports, etc. In the smaller towns this branch of legal work is usually combined with a general law practice, but in the larger cities it is as a rule a specialty, and those who are engaged in it are known as commercial lawyers.

The commercial lawyer endeavors to be in close touch with business conditions in his town or territory, especially with matters touching the financial condition and reputation of local merchants. For that reason his opinion with regard to the standing of mer-

chants is constantly sought by manufacturers and wholesalers who sell to tradespeople in his territory. Whenever it is necessary to proceed against an unwilling or incompetent debtor within reach of such an attorney, the creditor is generally glad to avail himself of his services.

Many commercial lawyers are capable, energetic and in every way dependable: some are probably less so. In a town where several lawyers handle commercial business, one may be wholly efficient and dependable in the conduct of a litigated case, but less reliable in handling ordinary collection items. Another may be found very good at collecting small amounts by dunning tactics, but a less desirable representative of the creditor in a case involving a large amount or a disputed account. A third may be a painstaking credit reporter, or have other qualities that distinguish him in some respects from his local colleagues.

The credit man or collection manager who sends his claim "direct," without employing a forwarding agency, labors under the disadvantage of not always knowing which attorney to select from among those whose names appear in the law lists. The agency, on the other hand, by reason of its larger volume of business, is generally able to select the man best qualified for the particular item of business in hand.

The attorney selected may be capable enough, but he may not always be so prompt as the collection manager desires. Since the collectibility of a claim rarely

improves with age, it is usually necessary to make certain that the lawyer presents it promptly and follows it up vigorously and persistently. To this end, frequent reports on the progress of the collection should be demanded. Unless the client is assured that his business is given prompt attention, it may be advisable for him to recall the claim and send it to another attorney in the debtor's town or in the vicinity. Such change, however, should not be made without apparent good cause, and whenever it is made, the new attorney should be told that the claim has previously been in the hands of another representative.

It sometimes happens that an attorney fails to account promptly to the client for the amount collected. If this is suspected, the client should assure himself of the fact which can usually be done if a little diplomacy is used. If proof can be given that the claim has been collected and no accounting rendered, the client may, if he has complied with the required formalities, recover the amount from the publisher of the law list from which the attorney's name was taken.

2. *Acknowledgment and report.*—The attorney is expected to send to the client an acknowledgment of the claim as soon as this is received by him. As he may be acquainted with the debtor's financial condition and present circumstances, he is often able to accompany the acknowledgment with an opinion as to the prospect of an early collection. He may know, for example, that owing to the debtor's condition there is little likelihood that the claim will be paid in the

immediate future, and that to bring suit would be of no avail, but that there is good hope of collecting the money in small instalments spread over a number of months. If the client has confidence in the attorney he may find it advisable to follow the lawyer's suggestion. If uncertain of the course to be followed, he should make an independent investigation before acting.

In case the attorney advises that suit be brought at once, the creditor should consent to that course only when he is reasonably certain that the collection cannot be effected in any other way. Suit is often expensive, and it almost certainly involves the permanent loss of the debtor's trade. The latter result may not be of very great consequence, yet it should always be taken into consideration. A reputation for readiness to bring suit against delinquent customers is not altogether desirable and may even work decided harm. Legal procedure should be employed only as a last resort.

3. *Justices and collectors.*—Whenever the law-list publishers are unable to secure an attorney as local representative of their lists they usually "refer" to the nearest town in which such representative is to be found. If on looking for an attorney at Brownsville, the list reads, "See Smithville," it indicates that claims for Brownsville should be sent to the attorney listed at Smithville. But where the two towns are too far removed from each other it frequently happens that the list gives under each the name of a justice of

the peace or a local collector. A justice or a collector often renders excellent service in the collection of small or medium-sized claims, often succeeding where an attorney has previously failed. Especially is this the case where, owing to the debtor's financial condition, the collection must be effected by means of persistent dunning. But if the claim involves litigation, it should generally be sent to an attorney, even if he lives at some distance away from the debtor's town. It is usually best, under such circumstances, to select the attorney who lives at the county seat.

As a rule, local collectors are not included among the law list's bonded representatives, hence the creditor employs them at his own risk and has no recourse to the publishers in case such collector should fail to account properly for moneys collected by him.

4. *The collection agency.*—Many manufacturing and wholesale houses prefer to place their out-of-town claims in the hands of good collection agencies, or "forwarding offices," as they are usually called. When this is done the creditor does not have to select or correspond with the local attorney, or to watch the progress of the collection. Since this method of handling claims involves the payment of no larger collection fee than if the claim were sent direct, and since it undeniably saves much time and labor, the plan has much to commend it. If, in addition, the creditor is assured that the agency is so equipped that it can give his claims intelligent attention and efficient service, the argument in favor of using a for-

warding office becomes still stronger. If, lastly, the integrity of the agency is beyond question, it appears that but little can properly be urged against this method of handling out-of-town collections.

Nevertheless, many credit men prefer to keep the collections in their own hands and dislike to use such an intermediary. Where claims are relatively few in number, but usually large in amount, this attitude appears more justifiable than where there are many claims of smaller amounts. The question is necessarily one to be settled by the credit man or collection manager himself.

In the larger cities forwarding offices are either operated by commercial lawyers, or an attorney is employed to take charge of the strictly legal part of their work. Such offices usually employ representatives to call upon wholesalers and manufacturers for the purpose of soliciting business in the form of out-of-town claims. Some forwarding offices conduct nation-wide advertising campaigns and as a result receive claims from all parts of the country.

5. *Procedure in forwarding claim.*—In the collection agency's office all claims to be forwarded are usually first entered upon a claim register and given a serial number. This entry shows name and address of creditor and debtor, the amount of the claim, and the date when received. For each claim a folder is made out in which all correspondence and information relating to the matter is placed. The folder is filed in such manner as to make it instantly accessible. If

it is decided to send the claim at once to a local attorney, one or more law lists are consulted, and the selection is made. Attached to the claim is a printed form giving the name of the law list from which the attorney's name was taken, the terms that are to govern the fee, which is always contingent upon collection being made, and giving a few brief instructions with regard to the procedure to be followed.

In case the client desires the claim handled in a certain way, this fact is communicated to the attorney at the time the claim is sent. In the absence of specific instructions the attorney will use his own judgment.

If the attorney does not acknowledge the claim promptly, the forwarding office writes to the attorney, reminding him of his omission and requesting an immediate report, usually adding that in the event of his inability to give the matter prompt attention, the claim should be returned forthwith. As a rule, however, the claim is acknowledged promptly. If possible, the attorney communicates with the debtor before making acknowledgment. If this cannot be done, the claim is merely acknowledged and a report promised within a few days.

6. *Reporting to client.*—Suppose the attorney writes to the forwarder that he has called upon the debtor and finds him unable to pay at the present time on account of prolonged local labor troubles or shut-downs of the factories in which his customers are employed, but that the factories are about to start

again and that the debtor says he will be able to make a substantial payment on account within one month. The attorney adds that he has personally investigated the situation and that he is convinced the dealer will do as he has promised. On receipt of this letter from the attorney, the forwarding office gives this information to the client.

The forwarding agency is constantly between two fires. It must keep the client satisfied that the claim is being pushed vigorously, and it must obtain from the attorney the best service he is capable of rendering. To satisfy the client, the agency must have frequent reports on the progress of the collection; at the same time it must not needlessly annoy the attorney with requests for reports when nothing of importance has taken place since the last report was submitted.

In order to be successful in its work, the agency must know how to maintain toward the client an attitude of deference to his wishes and a desire to keep him constantly informed with regard to the progress of his claims; and toward the attorney an attitude of watchfulness and energy, yet of absolute fairness and honesty in all transaction.

7. *Agency's record correspondence.*—As already mentioned, the agency provides a folder for each claim in which all correspondence relating to the claim is kept. Upon the folder itself, for the purpose of quick information, a record of the correspondence and an abbreviated synopsis of the letters sent and received is

usually kept. The following is a sample of such a record:

John C. Smith and Company

vs.

Fred W. Grubber.

- 9/15/16 Claims sent atty., Thomas F. Glass, Factoryville, Ill.
- 9/23/16 Att' reports: Saw dbtr. who says "unable pay now but will in six months." Other claims pending. Advises suit.
- 9/23/16 We write client.
- 9/26/16 Client says, Don't sue, collect by dunning.
- 9/26/16 We write atty.
- 10/20/16 We write atty. for report.
- 10/22/16 Client requests report on claim.
- 10/22/16 We write client.
- 10/30/16 Atty. says dbtr. neglects bus. Believes can collect by suit; wants \$5 for costs.
- 10/30/16 We write client.
- 11/ 2/16 Client sends sworn statement of a/c and check \$5 for costs.
- 11/ 2/16 We write atty.
- 11/14/16 Atty. writes filed suit; dbtr. offering 90 days' note indorsed by wealthy relative. Advises acceptance.
- 11/14/16 We write client.
- 11/16/16 Client writes accept note in settlement if indorsement O. K.
- 11/16/16 We write atty.
- 11/24/16 Atty. sends note for amt. of claim and also voucher court cost \$3 and bill for service \$15, one-third to us.
- 11/24/16 We write client inclosing note voucher and bill.
- 12/ 3/16 Client sends check \$13.
- 12/ 3/16 We send check \$8.

CLOSED.

8. *Collection agency drafts.*—Collection agencies frequently distribute to their clients free of charge a book of drafts for use in collecting past due accounts. Upon all collections made in this manner, the agency demands a commission of one per cent. Obviously this is seldom directly profitable to the agency, but the opportunity for profits comes when the draft is returned and when the claim thereby becomes a regular collection item and subject to the usual collection fee. Not infrequently the free draft is supplied on condition that the debtor fails to honor it on presentation, the claim automatically becomes a regular collection item for the agency.

In some cases, the draft bears upon its face instructions to the bank to deliver the draft, if unpaid, to the attorney whose name appears thereon. The latter form of draft is objectionable to many credit men on the ground that it prevents them from exercising their own judgment as to the subsequent handling of the returned draft, even tho the latter may bring information that points to the inadvisability of placing the claim in the hands of an attorney. At the same time this form of draft is likely to prove offensive to the debtor, since it cannot fail to make his delinquency appear to the bank in a very unfavorable light. The use of such a draft may indeed be a distinct injustice to the debtor, and may also prove injurious to the creditor.

When a stage is reached where, by every rule of collection practice, the claim should go to attorney,

little is ever gained by using the agency draft. More than likely, the credit man or collection manager has already made use of the draft in the earlier stages of the collection. Why repeat the attempt and waste additional time? It is nearly always better to send the claim without further delay to the attorney with instruction either to collect or to get security for the amount.

9. *The fake collection agency.*—Every now and then manufacturers and wholesalers are victimized by fake collection agencies that offer to collect old and outlawed accounts under a guaranty. A fee is exacted in advance, but the agency pledges itself to collect from two to five times the amount of the fee. This alluring bait is often swallowed by the unwary who of course never receive a single penny from the agency. The latter usually protects itself by leaving out of the contract all reference to the time limit within which it is to collect the promised amounts. Even when a time clause appears in the contract, as is sometimes the case, its value is vitiated by an added clause which gives the agency the right to extend the time as may be found necessary if, at the end of the contract period, any part of the amount remains uncollected. It need hardly be pointed out that the merchant who enters into a contract of this nature has no recourse in law.

10. *Collection fees.*—All collections are handled by the attorney on a contingent fee basis. Fresh commercial claims, that is, claims against a merchant or

trades person, are collected for a fee approximating ten per cent. In cases where special difficulty is encountered, the client may consent to allow a larger fee, but in the absence of any special agreement the fees stipulated by the list publisher and printed in the list govern the collection.

Instead of paying the lawyer to whom the claim was sent for presentation, the debtor sometimes remits direct to the creditor. In that case the lawyer is regarded as having earned his fee, which therefore should be sent him.

The following schedule of fees and other regulations are taken from one of the largest among the various law lists published in the United States:

On amounts up to \$200, 10 per cent.

On excess of \$200 to \$500, 7 per cent.

On excess of \$500 to \$1,000, 5 per cent.

On excess of \$1,000, 2½ per cent.

Minimum fee \$2. On claims under \$4, fifty per cent.

Authorization of suit is held in abrogation of fees previously agreed upon for collection, and if the (law list) company is to be held liable for overcharges where suit is authorized, new terms must be arranged.

Claims sent for collection should be accompanied by itemized statements, showing dates and terms of sale and credits for payment made or goods returned.

In case of suit, court costs in every case are paid by plaintiff, but no fee is paid except when recovery is made, unless a special agreement to that effect has been entered into.

Law lists are usually published quarterly, and are issued without charge or for a small subscription fee.

It is well to select one that has a large circulation and that is extensively used by forwarders of claims, since such a list usually commands better attorney service than one less widely used. Care should always be taken to see that the list selected has its representatives bonded by a responsible bonding company.

11. *Extra collection fees.*—It is ordinarily a mistake to expect the attorney to collect on a ten per cent basis a claim that is old and upon which already a considerable amount of work has been done by the house itself. In such a case, it generally pays to allow a liberal fee as an incentive to extra effort—twenty-five per cent and even more being not too much. To economize at this point is to invite a return of the claim as “uncollectible,” or to provide a place for it in a convenient pigeon hole in the attorney’s office, where it may be permitted to “sleep” indefinitely.

It sometimes happens that the attorney asks for a larger fee than that which ordinarily governs the collection on the plea that the claim, owing to various circumstances, will prove difficult to collect. While the reasons advanced may be valid, it will be well, before granting the attorney’s request for a larger fee, to investigate the circumstances. Should the attorney’s demand appear unwarranted, and should the amount involved be large enough to justify making a change of attorney, the claim may be recalled and sent to another representative. Any just complaint with regard to the attorney’s conduct in his handling

of business intrusted to him may be reported to the list publisher who will investigate such complaints.

12. *Assisting the attorney.*—When a claim is sent to an attorney for collection, the sender should take pains to state all the facts and circumstances relating to the claim, its origin, etc., including the steps thus far taken in attempting its collection. The more information that comes into the attorney's possession, the more intelligently and effectively can he proceed in his effort to make the collection of the debt. The debtor's attitude toward the claim—whether it is one of indifference, procrastination or hostility—should be known in advance. If the debtor disputes the correctness of the claim, the grounds upon which he disputes it and the creditor's answer thereto should be known to the attorney at the very beginning of his work.

Commercial attorneys frequently find that claims reach them that have previously been in the hands of two or more attorneys, tho these facts are not disclosed by the sender. Occasionally, after making the rounds of local attorneys, the claim may come back to one of them a second time thru another agency. Needless to say, such methods do not appeal favorably to a self-respecting attorney, nor do they increase his respect for the sender. It is only fair to the attorney that he be made acquainted with the history of each claim placed in his hands for collection.

REVIEW

How do you proceed when you wish to send a claim to an attorney in a distant town?

What may be said in favor of employing a forwarding agency in the collection of out-of-town claims, and what are the arguments commonly urged against such procedure?

What are the problems that commonly confront the forwarding office in the prosecution of its work?

At what stage in the collection of a past due account would you employ a draft?

## CHAPTER XIX

### RETAILERS' COLLECTION METHODS

1. *General principles.*—While the collection of accounts past due involves the same principles in retail and wholesale establishments, there are, nevertheless, some important differences in the methods employed in effecting the collections.

The basic collection principles are, of course, the same. These are, as we have seen (1) that every credit transaction is a contract the terms of which are binding upon both parties thereto, and (2) that the creditor is entitled to all necessary information relating to the debtor's ability to make payment according to the terms of sale. While the wholesaler deals with men who themselves are in business, and who therefore may be supposed to understand business principles, the majority of the retailer's credit customers are not in business. Except in certain lines of business they are chiefly women, and this fact necessitates different methods in collections. Not that women are less honest than men—probably the reverse is true—but they are not always so punctual in payment of bills. The creditor's reminder of an elapsed payment date often seems to them a reflection upon their integrity; and they do not consider the fact

that payments withheld involve a loss to the merchant in depriving him of the use of his capital.

In large department stores, such as Wanamaker's in New York City, where the charge accounts are said to number well over one hundred and fifty thousand, the total amount of outstanding capital is of course very large; and unless collections are made with regularity, the financial burden placed upon the house becomes a heavy one. When, moreover, it is considered that customers who have charge accounts pay no higher prices for their purchases than those who pay cash at the counter, the justice of insisting upon regularity in payments is readily seen.

2. *Prevailing collection policies.*—From the standpoint of the house, prompt collection is a matter of great importance, yet fear of offending a customer often dictates a collection policy that, viewed from any other standpoint, is wholly unwarranted. In some of the larger retail stores the rule obtains that an account must be sixty days overdue before the customer's attention is called to the matter, and then only in the mildest form possible. Subsequent notices are usually apologetic, and generally give the impression that the customer need not be in the least disturbed about the account, but may consult his—or her—own convenience in the matter of making payments. The collection policy of such houses may be said to be, in effect: "Get the money, if you can; but under no circumstances offend the customer!"

Frequently, in such houses, a customer will ask that

no monthly statements be sent. His (or her) wishes are promptly complied with. Others—and their number is much larger—do not wish to be called upon by the store's collector. Again, the customer's wishes are respected. Still others do not wish to be reminded of their indebtedness oftener than once, or at most twice, a year. If the customer is believed to be financially responsible beyond a doubt, this concession too is readily granted.

It is somewhat surprising to learn that despite this apparent laxity in collection methods, the actual losses from unpaid debts that are finally written off to profit and loss, represent only a very small percentage of the total volume of yearly sales. But the indirect losses caused by customers who disregard payment terms, who pay only "when they get ready" and who thus tie up part of the merchant's capital for months and sometimes even for years, are unquestionably very large. Such habits of the customer are in a great majority of cases simply the result of indifference and in no wise caused by inability to pay, but this does not mitigate the economic result.

3. *Importance of correct initial attitude.*—Tardiness in payment is often induced by the credit man's own attitude at the time when the account is opened. If he asks merely perfunctory questions and makes no reference to a credit limit, as is often the case, tho a limit is always put upon the account in the books, the customer carries away the impression that the house has no anxiety whatever about payments, and

promptly adjusts himself to this attitude. Under these circumstances a good share of the blame for subsequent tardiness or delinquency must be placed on the credit department of the store.

Frequently, however, the question of the amount of credit desired is in some way asked at the outset, and the time of payment is also briefly discussed. The customer may go away from the interview with the understanding that monthly purchases are not to exceed fifty dollars, and that payments for the month's purchases are to be made on or before the tenth of the month following. She may buy within that limit during the first month, but may exceed it materially during the month following. At the same time, as experience shows, she may have forgotten or wholly ignored the agreement that payment was to be made within a certain date. As a matter of fact, initial agreements and stipulations of that nature are soon forgotten, or if not forgotten, at least freely ignored. It depends, accordingly, upon the skill and efficiency of the collection department whether such a customer is to live up to her agreement.

So long as the fear of losing the customer is greater than that of losing the firm's money, no really vigorous collection methods can very well be followed. Courteous reminders in the form of periodically mailed statements and pleasantly worded letters have to be relied upon to bring the money; and only when these means fail must somewhat sterner measures be adopted. The latter may consist in turning the let-

ter-writing over to the "legal bureau," which usually is a part of the collection manager's office, tho the stationery and the address given suggest that the bureau is an independent organization, chiefly operated in the interest of the buying public for the protection of their credit standing. These letters are, as a rule, extremely courteous, and assume the tone of an impartial adviser, in which the possible injury to the customer's credit resulting from an inferior credit reputation is gently pointed out.

If this procedure is found unavailing, the creditor has his choice between suing for the amount and continuing his dunning methods. The former course is frequently ineffective, since there may be no property beyond the legal exemptions upon which the creditor could levy. It is also undesirable for another reason. A reputation for readily suing delinquent debtors is one that repels trade—at least from customers who desire to have a charge account. Legal measures are generally resorted to only when there is certainty that a judgment can be satisfied, and when it is patent that the debtor has no intention of settling the account amicably.

Lax payment-habits could often be avoided if a right attitude toward the subject were definitely taken at the opening of the account and persistently maintained thereafter. Such a course now generally adopted by wholesalers in their credit relations with the retail trade demonstrates that bad payment-habits are not incurable, and that a creditor's insistence upon

fairness and justice does not drive away desirable trade. The success of this movement gives ground for belief that a similar effect would follow a similar attitude on the part of merchants in the retail trade.

4. *The apologetic attitude.*—The present general practice in a majority of the larger retail stores is to send a statement once a month unless otherwise directed by the customer. In some stores, however, unless the account is materially in arrears, a statement is sent only once every two months. Such statement is, of course, merely an itemized list of the month's purchases, added to the balance remaining unpaid from the preceding month. When repeated statements fail to bring a payment, a brief note is usually sent.

A second letter may be sent after an interval of two weeks or more, if the first brings no response.

As soon as word is received from the customer, the next letter is phrased to meet the attitude revealed therein. If she is annoyed, the letter usually becomes apologetic, and assurance is given that there will be no further cause for complaint. If promise is made of payment, the letter expresses gratitude for the promise given. If the customer writes an evasive letter, the house collector may be directed to call, in order to learn, if he can, the actual reason for the non-payment of the account.

From this point onward, the tone and frequency of the missives are wholly governed by the customer's attitude and action.

5. *A correct collection attitude.*—While conditions differ and while stores that cater to the better class of customers can probably afford to maintain a liberal collection policy, there are other houses in which such a policy would be almost ruinous. The merchant with limited capital who allows accounts receivable to become unduly large, incurs the grave danger of being himself unable to meet his merchandise bills when these fall due. He should adopt a policy that is both sound economically and practical commercially.

That policy consists in making every charge customer understand from the beginning the mutual aspect of a credit transaction, and in fixing not only a definite credit limit but also the time and manner in which the account is to be paid. On the first day following the due date, in case payment has not been received, let a letter be sent to the customer reminding her that the omission is in violation of her own agreement.

6. *Sending the collector.*—The delinquent customer's card may be moved ahead two or three days; and if nothing is heard from the debtor, the store's collector is directed to make a call and investigate the situation. The collector should invariably be a courteous and tactful person, able to represent the store in a becoming manner. On his first call he may make no mention of the bill, but may state that as he had an errand in the neighborhood, he was asked by the manager to call and see whether the last goods had been delivered in good order and whether they were found

entirely satisfactory. The customer will almost invariably make some reference to the bill and probably offer some explanation of her omission to pay as agreed; but the visitor will refrain from discussing the matter unless it be to allay any irritation on the customer's part by assuring her that the house is most considerate of its patrons and is always anxious to please them in every transaction.

The collector's report will now determine the next step to be taken in the collection of this account. If an extension is desired, it will be granted, provided it is within reason; but in granting it, the credit man will obtain the customer's promise to make payment on or before a certain new date. Unless the full amount of the bill is to be paid on that date, he likewise obtains a definite promise as to the exact amount that is then to be paid. These items are, if possible, written down in the customer's presence. Thruout, the credit man's attitude is deferential and his manner pleasant. No suggestion of distrust or reproof should be noticeable in his manner or conversation. He appears to yield readily to the customer's request for time, and is simply mildly insistent that a definite date and a definite amount be fixed.

This combined courtesy and businesslike attitude of the credit man rarely fails to impress the customer; just as the promptness with which he follows up every due date has a strong tendency to make the customer prompt. This is not in the least strange when we consider that delay in making periodical payments is

largely a matter of habit. The collection manager's problem with regard to his lax customer is therefore simply that of substituting one habit for another.

7. *Instalment house collection.*—The instalment house, by reason of the nature of the goods it sells and the class of persons to whom it chiefly appeals, is compelled to inaugurate and maintain a rigid collection policy if its business is to be profitable. In the instalment business, more perhaps than in any other, it is necessary to bear in mind that no sale has yielded a profit until payment for the goods sold has been received by the seller.

The goods most commonly sold on the instalment plan are pianos, talking machines, sewing machines, furniture and household goods. The majority of buyers are wage-earners and their families. If the goods are taken back from non-paying customers, they can usually be resold as second-hand goods only at a part of the original price. The cost of transportation, storage and necessary repairs on such goods makes it unprofitable to take the goods back if it is at all possible to collect the money for them.

A large number of wage-earners, by reason of the nature of their work, may be here today, there tomorrow, and somewhere else next week. Even where their residence is relatively permanent, they may find themselves without work at any time. In this respect, as will be noted, they differ materially from the majority of charge customers in the city department store. But the instalment house cannot choose its

customers from among the people of "gilt-edge" credit standing. Whenever the customers' appearance and conversation do not distinctly make it appear unwise to open credit relations with them, they must, as a rule, be accepted as satisfactory credit risks.

This being so, the first step in collecting the account consists in obtaining as large a first payment as possible. As instalment sales are ordinarily in the nature of a lease—legal title to the goods remaining with the seller until the amount of the sales price has been paid to him by the buyer—the larger the first payment the less willing is the buyer to forfeit his interest in the goods thru non-payment of the remaining instalments.

Contrary to the usual opinion, the instalment house generally loses when it retakes goods, even tho as much as two-thirds or even three-fourths of the sales price has been collected. It follows therefore that the instalment house must practically collect the entire amount of the sale, if it is to make a reasonable profit on the transaction.

8. *Piano collections.*—Let us take as an example the piano business. In the case of low and medium priced pianos, nearly all sales are on the instalment plan. In this business it is found by experience that in order to make the transaction profitable, the contract price should be paid in full within three years. The dealer accordingly endeavors as nearly as possible to arrange such payment terms as will complete the transaction in thirty-six monthly payments. If

it is a three-hundred dollar instrument, an effort will usually be made to obtain a first payment of twenty dollars and to arrange for subsequent monthly payments of about eight dollars each. If the buyer cannot pay as much as eight dollars a month, he is advised to select an instrument costing less, so as to bring the sale within the three-year period.

The instrument being selected, the lease signed—in some states a mortgage duly recorded is required—and a first payment made, the date for future monthly payments is agreed upon and the piano is delivered at the buyer's house. Two or three days before the next payment date the buyer receives from the piano house a reminder that the next payment is about due. This is done in order that the buyer may not excuse possible tardiness by saying that he had forgotten or overlooked the matter.

If payment is not made on the day following the due date, a collector from the house calls at the buyer's house. He does not usually call in his capacity of collector, however, but merely for the purpose of learning whether the piano was delivered in good condition and whether the purchasers are entirely pleased with the instrument. Usually the buyer will make some reference to the instalment now due, upon which the collector admits that the bookkeeper, on learning that he (the collector) was going to call upon the new customer, asked him to take along the receipt for the second instalment, in case this had not already been paid by mail or otherwise. Whether or not he re-

ceives the payment at that time, the collector invariably obtains information that is of value to the collection manager in formulating the collection procedure to be followed in that case.

9. *Reaching the turning point.*—Until eight or nine payments are received, the collection methods employed are altogether deferential and void of all irritating insistence, altho during that time the collector is always at hand as soon as a payment is overdue, and no opportunity is afforded the customer to forget his obligation. When this point is reached, however, the collector becomes more insistent upon strict promptness. He explains to the customer that the house is obliged to demand regularity of payments in order to carry on its business of selling expensive articles on small monthly instalments.

This method, tho it may at times appear rather harsh, is, in the majority of instances, fully justified. A man who buys goods on instalments should consider in advance whether, barring accidents, he will be able to make the prescribed payments with due regularity. Having contracted to make such payments, he should be willing to carry out his agreement to the letter. He can have no just ground for complaint if the seller, having performed his share of the agreement, insists that the purchaser do likewise.

When actual disability thru illness or unemployment occurs, the buyer's account is usually carried until he is able to resume payments. It is not profitable to the seller to retake the goods if there is a reasonable

expectation that the amount owing will eventually be paid. The procedure here described applies in general to the collection of all instalment accounts.

10. *Collecting for service rendered.*—In certain classes of collections there is no opportunity to retake the goods purchased. Physicians' and dentists' bills are in this class. So also tuition fees, where these are to be paid in periodical instalments, and claims of other kinds where the goods bought have been consumed, or where at least they are not subject to re-possession by the seller.

In such cases, the first thing to be done is to secure the debtor's consent to a certain periodical payment plan. It is usually better to have the debtor agree to pay one dollar a week than to obtain his promise of twenty dollars "in a short time." Regularity of payment rather than the amount of each payment is the point sought. Fix upon an amount well within the debtor's ability to pay, and let it be understood that in return for the creditor's concession to accept such smaller payments, the debtor shall under no circumstances fail to make his periodical payments according to that agreement.

Let the debtor "get the habit" of making his payments on a certain date of the month or day of the week, and each payment made will serve to strengthen that habit. If there be a break in the continuity of the payments, the collector must immediately be on hand to reunite the broken ends and reestablish the interrupted payment habit.

With the various psychological appeals to human motives of action, such as pride of station, love of gain, ambition, fear, etc., we are not here particularly concerned. These come within the province of salesmanship by letter, since the same appeals that induce a person to part with money for the purchase of an article will also induce him to part with it for the payment of a debt. Our present discussion of the subject of collections is wholly from the viewpoint of equitable credit policies. It does not regard the payment of a just debt as a favor to be sought, but as an obligation to be met. It does not admit that a debtor may ever consult his own convenience in the matter of making such payment, but that on the contrary he must, if he desires to postpone the payment date, first obtain the creditor's consent to such postponement.

This view of the matter is not only sound in principle but also eminently satisfactory in practice. Success in business is not merely a question of selling a certain quantity of goods at a satisfactory price: it is as equally important that payment be received promptly and in full according to previously arranged terms of sale.

### REVIEW

What main considerations present themselves to the collection manager of a city department store who thinks of bringing suit against a delinquent debtor for the collection of a past due account?

What would be your attitude with regard to a customer's request for additional time in which to make a payment now due?

What are the chief features in a successful instalment house collection system?



## INDEX

### Accounting,

Liquidating values, 62; Credit terms in various lines of business, 160-74; Defective systems and failures, 194, 201-05

### Advertising, Efficacy of, 201; and credit title, 53-54

### Analysis of Credit Information,

Financial statement basis of mercantile credit, 133-34; Accounts receivable, 134, 135; Amount of cash for financing, 135; Assets as basis of credit, 136-37; Report and analysis to determine rating, 137-41; Mercantile agency report on clothing business, 141-44; Dun report on grocery business, 144-47; Dry-goods business report, 148-51; Boot and shoe business report and analysis, 151-54; Advance report and salesman's data, 154-59

### Assigned Accounts,

Creditors affected, 34-35; Recording to prevent fraud, 35

### Attachment, Conditions that constitute grounds for, 234-35

### Banking and Commercial Credit,

Inter-relation, 41-43; Canadian bank act, 43-44; "Loans and discounts," 45; Due dates, and bankers' cooperation, 58, 69; Source of credit information, 96-97

### Bankruptcy,

Meaning of, 238; Insolvency and legal definitions, 238-39; Distinction between bankruptcy and insolvency laws, 239-40; Kinds of bankruptcy, 240-41; Petitions, 241; Five acts of bankruptcy, 241-43; Pending adjudication, 243-44; Trial and relations of referee, 244; Creditors' meetings, 245; Selection of trustee, 245-46; Duties of bankrupt, 246; Schedules, 246-47; Valid claims, 247-48; Provable claims, 248-49; Allowable claims, 249-50;

### Bankruptcy—continued

Preferences, when voidable, 250; Priorities in estate distribution, 251; Dividend payments, 251; Court confirms composition, 252-53; Date of discharge, 253; Debts not cancelled, 253-54; Bankruptcy act on statute books, 254; Canadian practice, 254-55; Creditors' Relief Act, 255-56; Fraudulent conveyances and transfers, 256-57; Insolvent traders, 257-58; Dominion Winding-up Act, 258-59; When insolvent, 259-60; Debts and claims may be proved, 260; Bulk Sales Acts, 261

*See also* Why Merchants Fail

### Bradstreet, *See* Mercantile Agencies

**Bulk Sales Law, Fraudulent transfer,** 232-33; Statutory declaration, 261

### Bureaus of Credit,

Systems in retail trade, 275-76; Operations of a typical, 277-78; Canadian association, 278-80

### Burroughs Adding Machine Company, Problem in figuring profits, 204

### Canadian Insolvency Laws,

Bankruptcy procedure, 254-55; Creditors' Relief Act, 255; Judicial assignments, 256; Fraudulent conveyances, 256-57; Traders' insolvency, 257-58; Dominion Winding-up Act, 258-59

### Cannon, J. G., on "Individual Credits," 28

### Capital,

Analogy to wealth,\* 4; Credit not capital, 4, 13; Working power increased, 15-16; Too much invested, 18-19; Investment credit, 40-41; Acquisition of, and credit title, 62-63; Extending accounts determined by, 266

### Capital and Credit Ratings,

Difference between, 102; Extending accounts, 266

**Collection Agency,**

Efficient service of, 299-300; Forwarding office for claims, 311-14; Commercial lawyers employed, 312-14; Correspondence records, 314-15; Drafts, objection to, 316-17; Fake agencies, 317

**Collection Department,**

Wholesale house policies, 286-88; Delinquency causes, 288-89; Monthly statements, 289-90; Collection letters, 290-96; Notice of draft, 292-94; Services of attorney, 295-98; Character of letters important, 298-99; Agency service, 299-300, 311; Adjusters' and National Bankruptcy Act, 300-01; Unearned discounts, 301-03; Deferred payment interests, 303-04; Defective remittances, 304-05; Commercial lawyers, 307-09; Attorney's acknowledgment of claim, 309-313; Suit at law, a last resort, 310; Justices and collectors, 310-11; Forwarding-office agencies, 311-13; Progress report of claims, 313-14; Agency records, form of, 314-15; Collection drafts objectionable, 316; Fake agencies omit time clause, 317; Schedule of fees, 318; Law lists bonded, 318-19; Extra fees, 319; Assisting the attorney, 320

*See also* Retailers' Collection Methods

**Collection Letters, *See* Collection Department and Retailers' Collection Methods****Commercial Attorneys,**

Obtaining credit information, 91-92; Law lists and free reports, 92-94; Form of paid report, 95; Collecting claims, 295-300; Commercial lawyers, and law lists, 307-09; Acknowledging claims and legal procedure, 309-10; Service in forwarding office, 311-14; Collection fees contingent, 317-19; Attorney's information regarding claim, 320

**Commercial Crises, Henry D. MacLeod describes over-production, 24-25****Confidence and Contract,**

Significance to credit, 7, 26; Banking credit turned into commercial credit, 41-43; Determining credit title, 47, 65

**Consolidating Building Trades Credit Association, Activities of, 114-15****Cooperation,**

Ledger experience interchange, 116-18; National Association of Credit Men approve blank forms, 118-19; Central bureau of information, 120-22; Credit clearing, 123-28; Credit man and the sales department, 177-78; Business service department, 188-89; Value of, with customer, 189-91; Credit office system of, 207-08

*See also* Cooperative Methods in Credit Investigation

**Cooperative Methods in Credit Investigation,**

Interchange of ledger experience, 116-17; Payment records, and blank forms, 118-20; Central bureau for credit interchange, 120-22; Credit clearing, defects of, 123-25; Credit Clearing House, and percentage system, 125-28; International system and items of, 128-31; Credit interchange valuable, 131-32; Retail stores accounts, 273-81

**Credit a Business Builder,**

Working power of capital, 15-16; Excessive credit and annual sales, 16-17; Amount capital invested, 18-19; Bank credits the manufacturer, 19-20; Seasonal lines of business, 20; When credit is legitimate, 21, 23, 25; Goods the object of trade, 22-23; Economic basis of credit, 23-24; Illegitimate credit, 23, 25; Over-production and commercial crises, 24-25; Cause of panics, 25

**Credit Clearing,**

Inherent defects of, 123-25; Source of credit information, 69

**Credit Clearing House,**

Investigation and reports, 125-26; Percentage payments, 126-27; Service to subscribers, 127-28

**Credit Management of Retail Stores,**

Economics of personal credit, 262-78; Problems of credit title, 264-66; Outstanding accounts and payment methods, 266; Basis of credit extension, 267-68; Terms and time extension, 268-69; Charge accounts opened, 269-71; Safeguarding accounts, 271-73, 282; Retailers' credit interchange, 273-76; Rating blanks, 276-77; Typical bureau in Ohio, 277-78; Canadian credit association, 278-80; Instalment house

**Credit Management—continued**  
 methods and risks, 280-81, 284;  
 Payments, and customers' verification, 281-84

*See also* Retailers' Collection Methods

**Credit Office Routine,**

Selection of system, 207; Tests of system, and illustration, 208-09; Financial statement sought, 209; Advance information about prospects, 210; New customer report, 210, 211; Direct inquiry ticket, 211; New orders and department routine, 211-12; Investigation and salesman's notice, 212-13; Filing orders and card ledger systems, 213-14; Statement of assets and liabilities, 214-15

**Credit Practice in Representative Lines of Business,**

Irregularity of credit terms, 160-61; Customary practice in grocery business, 161-63; Customary terms in meats and provisions, 163-64; In hardware, 164-66; In boots and shoes, 166-68; In textile, 168; In woollens, cottons, silks and linens, 168-70; In shirts and collars, 170-71; In suits and cloaks, 171; In lumber, 171-72; National Wholesale Lumber Dealers' Association adopts schedule, 172; Customary terms in furniture business, 173; Jewelry business, 173-74

*See also* Credit Management of Retail Stores

**Credit Protection,**

Agencies and legal measures, 216; Credit insurance, 216-18; Arguments for, 218-19; Arguments against, 219-21; National Association of Credit Men, objects of, 221-23; Association's ethics, 223-24; Adjustment bureaus, 224; Recovering losses, 225-26; Unpaid seller may retain possession, 226; Stoppage *in transitu*, 226-27; Resale and profit, 228; Fraud and recovery, 228; Litigation proceedings, 229; Evidence important, 230; Enforcing judgment, 230-31; Exemptions, digest of, 231; Supplementary proceedings, 231-32; Fraudulent conveyances, 232; Bulk Sales Law, 232-33; Receivers, 233; Garnishment, 233; Attachment, grounds for, 234-35;

**Credit Protection—continued**

Imprisonment for debt statutory, 235; Creditors and criminal courts, 235; Litigation to be avoided, 236

**Dennis, Stanley A.,** Statistics on business failures, 192-93

**Division of Credits,**

Time element and collateral, 26-27; Personal credit and abuse of, 27-30; J. G. Cannon on "Individual Credits," 28; Mercantile credit and commercial transactions, 30-31; Short-time payments advised, 31-32; Open accounts, 32-33; Book accounts discounted, 33-34; Assigning accounts, and legislation to protect creditors, 34-36; Trade acceptance, and advantages, 36-39; Credit Men's Association form of acceptance, 39-40; Consumption goods and capital goods, 40-41; Banking credit's relation to commercial, 41-43; Latitude of bank's credit, 43-44; Federal Reserve Act and real estate security, 43-44; Canadian bank loans and security, 43-44; Commercial paper—"loans and discounts," 44-45; Bank classifications of "business paper," 45

**Dominion Bank Act,** Credit investments restricted, 43-44

**Dominion Winding-up Act,** Incorporated companies insolvency, 258; Determination of, 259

**Dun Reports,**

Cooperation determines credit, 58-59; Determining credit title, 137-41; Grocery business summary, 144-47; Success minus experience, 151-54; Commercial failures, 187; New orders, 211

*See also* Mercantile Agencies

**Exchange,**

Credit, medium of, 1-13; Commodities as barter, 5; Money metals replaced by credit, 5-6, 9-12; Goods the object of trade, 22

**Factors that Determine Credit Title,**  
 Ability and willingness to pay, 47; Business capacity and moral character, 47 et seq.; Credit

**Factors—continued**

title in wholesale trade, 48-55;  
 Ability and success, 48-63, 66;  
 Technical knowledge thru experience, 49-50; Buying methods, 50-52; Overbuying and failures, 50-51; Anticipating the market, 52; Equipment and profits, 53; Advertising and output, 53-54; Location and rent, 54; Age and ability, 55-56; Financing methods, 56-60; Outside ventures may imperil credit, 57; Due dates properly distributed, 58; Relations with banker, 58; Cooperation with mercantile agencies, 58-59; Insurance, 59; Payment habits, 60; Assets must exceed liabilities, 60; Fixed and liquid assets, 61; Liquidating values, 62; Acquiring capital, 62-63; Relation of moral character to credit, 63-66

**Failure,**

Annual sales should govern buying, 16-17; Misuse of credit, 18; Illegitimate credit causes, 25; Assigning accounts, 34-35; Technical ability prevents, 49-66; Percentage system of payment, 126-27; Commercial agency reports, 154-59; Dun reports on, 187; Service to prevent, 188-91; Chief causes, 194 et seq.; Defective accounting, 201-08

See also Bankruptcy

See also Why Merchants Fail

**Federal Reserve,** Bank loans on real estate, 43-44

**Financial Ability,** Determines credit, 47, 56-63, 66

**Furniture Commercial Agency Company,**

Red Book of ratings—credit, capital, and pay, 110; Numerals and conditions indicated, 111; Reporting service, 111-13

**Garnishment,** Process of credit protection, 233

**Goods Economic Basis of Credit,** 22-24

**Government Bank Notes,** Credit instruments, 10-11

**Imprisonment for Debt, Unusual resort,** 235

**Instalment House Credit,**

Firm's security, 280-81; Information verified by investigation, 282-83; Fraud prevention, 284; Collection methods; Periodical payments enforced, 334

**Insurance,**

Factor in credit title, 59; Credit indemnity companies, 216-18; Arguments for and against credit insurance, 218-21

**Iron and Steel Board of Trade,**

Lines of service, 106-07; Blue Book of credit ratings, 107; Inquiry forms, sample of, 107-09; "Watch Service," 108

**Jewelers' Board of Trade,**

Service and reports, 109; Prosecution fund, 110

**Leather Mercantile Agency, Service and reports,** 113

**Legitimate Credit, Profits based upon goods in possession,** 21, 23, 25  
**"Loans and Discounts,"** Bank classification, 44-45

**Mercantile Agencies,**

Dun and Bradstreet service, 98-99; Lewis Tappan and Company, pioneers, 98-99; Commercial reporters, 99-100; Kinds of information, 101; Rating books distribute, 101; Capital and credit ratings, 102; Key to Dun's ratings, 102; Key to Bradstreet's, 103; Credit reports for subscribers, 104; Trade and market reviews, 105; Cost of service, 105; Special trade agencies, 105-06; Iron and Steel Board of Trade, 106-08; National Jewelers' Board of Trade, 109-10; Furniture Commercial Agency Company, 110-13; Leather Mercantile Agency, 113; Consolidated Building Trades Credit Association, 114-15; Analysis of reports, 137-59

See also Sources of Credit Information

**Mercantile Credit,**

Distribution and sales, 30-31; Mercantile agencies protect, 98-115

## Mercantile Credit—continued

See also Analysis of Credit Information

See also Credit Management of Retail Stores

Moller and Schumann Company, Business service department, 188-89

## Money versus Credit,

Merchandising profits, 15-20;  
Money basis of business credit, 26

## National Association of Credit Men,

Model form of trade acceptance drawn by, 89-90; Reciprocal credit information, 119-20; Organization and objects of, 221-22; Commercial ethics, 223-24; Adjustment bureaus, 224-25; Statutory bankruptcy laws, 254

National Wholesale Lumber Dealers' Association, Customary credit terms, 172

## Nature and Functions of Credit, 1-13;

Definitions of credit, 3-4, 7; Growth and development of exchange mediums, 4-6, 8; Confidence basis of, 6; Contract prevents abuse, 6-7; Dates of payment, and discounts, 7-8; Daniel Webster quotes, 9; Promissory notes, checks and drafts replace gold, 9-10; Bank and government money, 10-11; Bills of exchange, 12; Credit money and gold, 12-13

## New Orders,

Salesman's credit information, 83-88; Analysis of credit information, 133-59; Credit office routine, 207-15; Retail store methods of determining credit standing, 262-84

## Overbuying,

Determining annual sales, 16-17; Technical ability to prevent, 50-53; Merchandise on hand and annual sales, 133-34 et seq.; A cause of failure, 194, 198, 200

Percentage Payments, Credit Clearing House reports, 126-28

## Personal Credit,

Unorganized system, 27-28; Dan-

## Personal Credit—continued

gerous influence upon commercial system and prices, 28-30; Retail stores, 262-64

Priority of Debts, Division of assets in bankruptcy, 250-51

## Profits,

Ability determines credit title, 47-66; Equipment affects assets, 53; Right selling price, 204-05

## Property Statement,

Mutuality of interest, 69-70; Importance of, 70-71; Frequency and value, 71-73; Bank and commercial forms, 73-83; 84-85; Financial statement forms, merchandise on hand, 133-59; Discrimination of, 267-78, 282-83

## Retailers' Collection Methods,

Basic principles of, 322-23; Policy regarding customers, 323-24; Initial attitude of credit man, 324-25, 328; Reminders of payments due, 325-27; Collector's attitude, 328-29; Instalment house collection, 330-32; Methods of enforcing payments, 333; Periodical payment plan, 334; Equitable policies, 335

See also Collection Department

See also Credit Management of Retail Stores

Retail Selling, See Credit Management of Retail stores

Salesman a Credit Reporter, Forms for information, 83, 85-88

Short-Time Credit, Replaces long-time payments, 81-82

## Sources of Credit Information,

Reliability of informant, 67-68; Overestimated references, 68; Five important sources, 69; Wholesaler and retailer, mutual interest of, 69-70; Property statement a safeguard, 70-71; signed statements and firms' attitude, 72; Property statement forms—individual and corporation, 73-82; Credit Men's Association approves forms, 82; Form questions, 82; Individual form of Liberty National Bank, 83, 84-85; Salesman a credit reporter, 83, 85-88; Salesman's data forms, 86, 88; Traveling credit man, 88-90; Form of re-

**Sources of Credit Information—**  
 continued  
 port, 90-91; Attorney as credit  
 reporter, 91-92; Law lists and  
 free-report system, 92-94;  
 "Paid"-report form, 95; Banks  
 and credit information, 96-97  
*See also* Mercantile Agencies  
**Statement of Accounts, Preceding**  
 date of maturity, 289-90  
**Stoppage in Transitu, Shipper's**  
 rights, and Uniform Sales Act,  
 226-27

### **Technical Ability,**

Factors that determine credit, 49-  
 66; Relation to financing, 56-  
 57

### **Terms of Credit,**

Dissimilarity in various trades,  
 160-74; Retail store accounts,  
 268-84; Collection principles,  
 287-88; Tardy payments and  
 credit man's attitude, 324-29

*See also* Credit Practice in Repre-  
 sentative lines of Business

### **The Credit Man,**

Efficiency in checking orders, 175-  
 76; Cooperation with sales de-  
 partment, 177-78; Attitude to-  
 ward customer, 178-80; Abilities  
 and mental acumen, 180-82;  
 Moral standards, 182-83; Busi-  
 ness education, 183-86; Promot-  
 ing customers' business, 186-88;  
 Moller and Schumann Company's  
 service department, 188-89; Cus-  
 tomer's cooperation, by H. O.  
 Workmaster, 189-91

### **Trade Acceptance,**

Cash discounts, 36-38; Advantages  
 of, 38-39; Form approved by  
 Credit Men's Association, 39-40

### **Traveling Credit Men,**

Responsibility and service of, 88-  
 90; Information form, 90-91

### **Turnover,**

Value of stock and sales, 138-34;  
 Overbuying causes failure, 194-  
 95, 198; Ratio to capital in-  
 vested, 199-200

### **Uniform Sales Act, Insolvency and credit protection, 227**

### **Why Merchants Fail,**

Failures, and investigation to pre-  
 vent, 192; Statistics by S. A.  
 Dennis, 192-93; Overbuying and  
 poor collections cause failures,  
 194, 198, 201; Wrong location  
 and bad accounting, 194, 195-  
 96, 197, 201-02; Lack of enter-  
 prise and upkeep, 196-97; Poor  
 display, 197; Inefficient sales  
 people, 197-98; Mistakes in buy-  
 ing, 198-99; Slow turnover, 199-  
 200; Credits and collections, 200-  
 01; Unsuitable advertising, 201;  
 Depreciation on goods and other  
 expense factors, 202-03; Fig-  
 uring profits and Burroughs Com-  
 pany problem, 204; Computing  
 the selling price, 204-05

*See also* Bankruptcy

**Workmaster, H. C., on Cooperation**  
 with customer, 190-91